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HOUSE OF REPRESENTATIVES

TAX AND SUPERANNUATION LAWS AMENDMENT (2016 NATIONAL INNOVATION AND SCIENCE AGENDA) BILL 2016: ACCESS TO LOSSES

EXPOSURE DRAFT EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Scott Morrison MP)

Table of contents

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
Commissioner	Commissioner of Taxation
ITAA 1997	*Income Tax Assessment Act 1997*
ITAA 1936	*Income Tax Assessment Act 1936*

National Innovation and Science Agenda: Access to Losses

Outline of chapter

1.1 This Exposure Draft Bill contains proposed amendments to the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936) to supplement the same business test with a more flexible similar business test to improve access to losses for companies that have changed ownership. Under the proposed amendments those companies will be able to deduct losses if they satisfy the similar business test, which is framed to allow companies to seek out opportunities to innovate and grow without losing access to losses.

Context of amendments

1.2 Where a taxpayer has more deductions for an income year than they have assessable and exempt income, the difference is a tax loss (section 36-1 of the ITAA 1997).

1.3 A tax loss for an income year (the loss year) can be carried forward and deducted from assessable income in future income years. However, a company must pass either:

- the continuity of ownership test, which is failed if the company has undergone a substantial change in ownership or control; or
- the same business test, which is failed unless the company carries on the same business and has not derived income from new kinds of transactions or new kinds of business.

The continuity of ownership test

1.4 A company fails the continuity of ownership test if it undergoes a substantial change in ownership or control within the period from the start of the loss year to the end of the income year in which it seeks to utilise a prior year loss.

1.5 There is a modified continuity of ownership test for widely-held and other eligible companies (Division 166 of the ITAA 1997).

The same business test

1.6 To pass the same business test, a company must carry on the same business throughout the 'same business test period' that it carried on immediately before the 'test time'.

1.7 Generally, a company satisfies the same business test if it carries on the same business in the income year in which it seeks to recoup losses (the 'same business test period') as it carried on immediately before the change of ownership or control that caused it to fail the continuity of ownership test (the 'test time') (see subsection 165-13(2) of the ITAA 1997).

1.8 Additionally, a company will not satisfy the same business test if either of the negative limbs of the same business test is met. The negative limbs look at the component undertakings and transactions of the company and are met if, throughout the same business test period, the company:

- derives assessable income from a kind of business that it did not carry on before the test time (new business test, paragraph 165-210(2)(a) of the ITAA 1997); or
- derives assessable income from a transaction of a kind that it had not previously entered into in the course of its business before the test time (new transaction test, paragraph 165-210(2)(b) of the ITAA 1997).

1.9 On 7 December 2015, the Government announced a package of measures designed to incentivise and reward innovation as part of its National Innovation and Science Agenda. One of those measures is to supplement the same business test with a more flexible similar business test. This is because, by threatening access to past year losses, the same business test may deter companies from seeking out new business opportunities. These changes encourage entrepreneurship by allowing loss-making companies to seek out new opportunities to return to profitability.

The relevance of the same business test

1.10 The same business test is not only used for working out whether tax losses from previous income years can be utilised. The same business test is also used to work out the following:

- whether a company can apply a net capital loss from a previous year, incurred prior to a change of ownership or control against current year capital gains (see Subdivision 165-CA of the ITAA 1997);

- whether certain companies can use losses, including trading stock losses, in respect of CGT events that happen to CGT assets that it acquired prior to a change of ownership or control (Subdivision 165-CC of the ITAA 1997);

- whether a company can deduct a debt written off as bad in an income year, where the debt was initially incurred prior to a change of ownership or control (see Subdivision 165-C of the ITAA 1997);

- whether and how the special methods for working out a company's taxable income and loss, and net capital gain and loss for the income year in which the company has undergone a change of ownership or control apply (see Subdivisions 165-B and 165-CB of the ITAA 1997); and

- whether a company joining a consolidated group can transfer its losses to the head company (see Division 707 of the ITAA 1997).

1.11 There is also a parallel same business test with respect to listed widely-held trusts (Subdivision 269-F in Schedule 2F to the ITAA 1936). This parallel same business test is relevant to working out:

- whether the trust can utilise losses from years preceding a change of ownership or abnormal trading in the units of the trust (Subdivision 266-D in Schedule 2F to the ITAA 1936);

- whether the trust can deduct a debt written off as bad, where the debt was incurred in years preceding a change of ownership or abnormal trading in the units of the trust (Subdivision 266-D in Schedule 2F to the ITAA 1936); and

- whether the special way for working out the trust's net income and tax loss in an income year in Division 268 of Schedule 2F to the ITAA 1936 applies, as a consequence of an abnormal trading that results in a change of ownership.

Time periods for which the same business test must be satisfied

1.12 A company satisfies the same business test if it carries on the same business throughout the 'same business test period' as it carried on immediately before the 'test time'.

1.13 The 'same business test period' and 'test time' vary depending on the purpose for which the same business test is applied.

Summary of new law

1.14 This Exposure Draft supplements the 'same business test' with a more flexible 'similar business test', for the purposes of working out whether a company's tax losses from previous income years can be utilised.

1.15 Additionally, the similar business test will supplement the same business test for the other purposes for which the same business test currently applies (such as in working out whether a debt written off as bad can be deducted in an income year, and for certain purposes with respect to listed widely held trusts).

1.16 In working out whether the business carried on throughout the business continuity test period (the 'current business') is similar to the business carried on immediately before the test time (the 'former business'), regard must be had to three factors, which are not exhaustive:

- the extent to which the assets (including goodwill) that are used in its current business to generate assessable income were also used in the company's former business to generate assessable income;
- the extent to which the sources from which the current business generates assessable income were also the sources from which the former business generated assessable income; and
- whether any changes to the former business are changes that would reasonably be expected to have been made to a similarly placed business.

Comparison of key features of new law and current law

New law	*Current law*
The *same business test* is retained.	Where a company has undergone a change of ownership or control, it may access losses from years preceding the change if it passes the *same business test*.

	A company passes the same business test if its current business is the same business as its former business.
Where a company has undergone a change of ownership or control, it may also access losses from years preceding that change if it passes the similar business test. A company passes the similar business test if its current business is a similar business to its former business. This is worked out, having regard to: • the extent to which the company generates assessable income from the same assets and sources, and • whether any changes to the business are changes that would reasonably be expected to have been made to a similarly placed business.	No equivalent.
The *same business test and the similar business test* also apply for other purposes (including in relation to listed widely held trusts).	The *same business test* also applies for other purposes (including in relation to listed widely held trusts).

Detailed explanation of new law

The similar business test

1.17 This Exposure Draft supplements the existing same business test with a new and more flexible similar business test. A company will satisfy the similar business test if its current business is a similar business to its former business. The similar business test also applies with respect to listed widely held trusts.

1.18 Generally, a company satisfies the similar business test if the business it carries on throughout the income year in which it seeks to utilise a loss (the 'business continuity test period'[1]) is a similar business to the business it carried on at the time immediately before the change of

[1] The 'business continuity test period' is the same as the 'same business test period'.

ownership or control that caused it to fail the continuity of ownership test (the 'test time'). ***[Schedule 1, items # and #, subsection 165-211(1) of the ITAA 1997, subsection 269-105(1) in Schedule 2F to the ITAA 1936]***

1.19 Currently, companies that have received new equity investment (such that they fail the continuity of ownership test) may be discouraged from innovating or from adapting to changes in economic circumstances by the need to satisfy the same business test to utilise prior year losses. In particular, the two negative limbs in the same business test may discourage companies from entering into new kinds of transactions or new kinds of businesses.

1.20 As with the same business test, the focus of the similar business test is on the *identity* of the business. It is not sufficient that the current business is of a similar 'kind' or 'type' to the former business. For example, it is not enough to say that the former business was in the hospitality industry and the current business is in the hospitality industry. Instead, the test looks at all of the commercial operations and activities that the former business carried on and compares them with all of the commercial operations and activities that the current business carries on, to work out if the businesses are similar.

1.21 In working out whether the current business is similar to the former business, regard must be had to three factors, which are not exhaustive:

- the extent to which the assets (including goodwill) that are used in its current business to generate assessable income were also used in the company's former business to generate assessable income;
- the extent to which the sources from which the current business generates assessable income were also the sources from which the former business generated assessable income; and
- whether any changes to the former business are changes that would reasonably be expected to have been made to a similarly placed business.

[Schedule 1, items # and #, subsection 165-211(2) of the ITAA 1997, subsection 269-105(3) in Schedule 2F to the ITAA 1936]

1.22 As with the same business test, whether the current business is similar to the former business is a question of fact. For the similar business test, regard must be had to each of the three factors. The factors should be considered in the light of the overarching question of whether the current business is a similar business to the former business. In some circumstances, a factor may suggest that the similar business test is satisfied, while another factor suggests that the similar business test is not satisfied. This will require the factors to be weighed up. The relative importance of each of the factors will depend on the facts of the particular case.

1.23 The three factors allow for differences between the current and former businesses that result from attempts to grow or rehabilitate the business. However, they also mean that there should be clear similarity in the identity between the operations of the former business and the current business. If a business changes its essential character, or if there is a sudden change in the business brought about by either the acquisition or the cessation of activities, then the business would fail the similar business test.

Factor 1: same assets used to generate income

1.24 The first factor is the extent to which the assets (including goodwill) that are used in its current business to generate assessable income throughout the business continuity test period were also used in the former business to generate assessable income. The term 'assets' extends to physical and intangible assets. Intangible assets include the trade names, trademarks, patents, royalty arrangements, and other intellectual property rights of the company. ***[Schedule 1, items # and #, paragraph 165-211(2)(a) of the ITAA 1997, paragraph 269-105(3)(a) in Schedule 2F to the ITAA 1936]***

1.25 Goodwill will generally be a particularly relevant asset in this factor. Goodwill is the product of combining and using the tangible, intangible and human assets of a business for such purposes and in such ways that custom is drawn to it. The attraction of custom is central to the legal concept of goodwill. Goodwill is a quality or attribute that derives from, among other things, using or applying other assets of a business. It may derive from a site, personality, service, price or habit that obtains custom.[2]

Factor 2: assessable income generated from the same sources

1.26 The second factor is the extent to which the sources from which the current business generates assessable income were also the sources from which the former business generated assessable income. ***[Schedule 1, items # and #, paragraph 165-211(2)(b) of the ITAA 1997, paragraph 269-105(3)(b) in Schedule 2F to the ITAA 1936]***

[2] See paragraph 12, Taxation Ruling TR 1999/16.

1.27 The sources of the company's assessable income are the specific activities or operations from which it generates assessable income. For example, if a company ran an Italian restaurant, and then opened up a takeaway fish and chips shop, the takeaway fish and chips shop would amount to a new source of assessable income.

Factor 3: changes to a similarly placed business

1.28 The third factor is whether any changes to the former business are changes that would reasonably be expected to have been made to a similarly placed business. ***[Schedule 1, items # and #, paragraph 165-211(2)(c) of the ITAA 1997, paragraph 269-105(3)(c) in Schedule 2F to the ITAA 1936]***

1.29 This factor requires taking a hypothetical business that is similarly placed to the company's former business, and asking whether or not a reasonable person would expect the changes to be made to that business.

1.30 By hypothesising what a reasonable person would expect when looking at the similarly placed business, this factor looks for a degree of organic connection and continuity between the former business and the current business. It is not sufficient that the change is a reasonable business decision in that it makes commercial sense, or is a good business opportunity. Rather, there must be something in the activities or operations of the former business that make the change a natural one that a reasonable person, looking at the former business would have been able to predict.

1.31 Importantly, this factor looks at *the business* of the company, rather than the company itself. That is, it focusses on the commercial operations and activities that the company carries on, rather than the structure of the company itself. Because this factor is an objective test that fixes on the nature of the business itself, rather than the company, the idiosyncratic circumstances and connections of the company and its owners are irrelevant. For example, the fact that the company has a related entity involved in a certain line of business, which makes expansion into that line of business attractive, should not be attributed to the hypothetical similarly placed business.

Example 1.1: Similar business test passed

Furnish Art Pty Ltd is a start-up online retail company that sells various household furniture items from established brands. In its first year, Funish Art made a tax loss.

Through conducting this business, the company discovered that there was a market for affordable, high quality mattresses.

While it continues selling furniture from established brands, Furnish Art decided to expand the mattress component of its business. To acquire funds necessary to implement make this change, Furnish Art gained a new equity investor, causing it to fail the continuity of ownership test.

Furnish Art researched and developed its own mattresses (and applied to register its intellectual property with IP Australia) and it outsourced the manufacturing to a local factory.

Furnish Art commenced selling its new mattresses through its website and under its established 'Furnish Art' brand name, alongside the other furniture products. Approximately 15 per cent of Furnish Art's sales are from its specialised mattresses.

Furnish Art then became profitable and sought to recoup the tax losses incurred prior to the ownership change.

Furnish Art would satisfy the similar business test.

With regard to the first factor, the current business is generating income from the same assets as the former business in so far as it continues to generate income from its brand name and goodwill. However, it is also generating income from a new asset: the intellectual property from the mattress designs.

With regard to the second factor, the current business is generating income from the same sources to the extent that it is generated from the online reselling of furniture items from established brands. However, income is also generated from the sale of the specialised mattresses Furnish Art developed.

With regard to the third factor, the change to the business is one that would reasonably be expected to be made by a similarly placed business. There is a change in Furnish Art's business from reselling established products to both reselling established products and selling mattresses it has developed itself. However, the change is one that supplements the former business as a subsidiary or ancillary business activity, rather than replacing it. This indicates that the current identity of the Furnish Art business is sufficiently similar to the identity of the former business.

Overall, the above analysis of the factors leads to the conclusion that the former business and the current business are sufficiently similar to satisfy the test. The identity of the Furnish Art business has been maintained, and the extent to which the business has changed and derived income from new assets and sources do not outweigh the similarities.

This conclusion would likely be different if Furnish Art ceased to sell other furniture products and instead became exclusively an online retailer of mattresses which it developed itself.

Example 1.2: Similar business test passed

RePoly Pty Ltd has developed a way to turn algae into biodegradable plastic. To do this it incurs large initial expenditure on research and development and manufacturing technology. In the first three years of operation, RePoly makes a loss.

To ensure its viability, RePoly brings in an early stage investor who contributes additional equity capital. This results in a majority change in ownership, causing RePoly to fail the continuity of ownership test.

After this change, RePoly seeks to expand its business in an effort to reach profitability. It discovers that the algae treatments that it uses to make the plastics can also be used to make a teeth-whitening product. Sales to overseas dentists of the teeth-whitening product become a small part of RePoly's business. RePoly reaches profitability in its fourth year of operation and seeks to offset its past losses against current year profits.

RePoly would satisfy the similar business test.

On the one hand it is generating assessable income from different sources to the extent that it is generating income from selling teeth-whitening products (the second factor). However, it is notable that the sale of plastic still continues to be a central part of the business's income-generating activities.

With regard to the first factor, it is significant that RePoly generates its income from the same key asset (the intellectual property relating to the unique algae treatments) with respect to both the biodegradable plastic and teeth-whitening products. It also continues to generate assessable income from its specialised manufacturing technology. On the other hand, the existing goodwill in relation to the business's reputation for selling biodegradable plastic products would have limited utility in relation to the sale of the teeth-whitening products.

With regard to the third factor, the disjunct between selling biodegradable plastic and selling teeth-whitening products to dentists, suggests that this is a change to the former business that would not reasonably be expected to have been made to a similarly placed business. However, the fact that this change is the result of an adaptation of a highly unique intellectual property asset (the algae treatment) for a new purpose tempers this conclusion.

Overall, the continued centrality of the unique algae treatment to the business, combined with the fact that the biodegradable plastic business continues to be the most substantial part of the business is enough to cause the similar business test to be satisfied. In this case, this is enough to outweigh the fact that the sale to dentists for a teeth-whitening product is a new source of income, and that it is in some ways, a change to the business that would not reasonably have been expected of a similarly placed business.

This conclusion would likely be different if RePoly ceased to sell biodegradable plastic products and instead focused exclusively on the manufacture and sale of teeth-whitening products.

Example 1.3: Similar business test failed

Peach & Ice Co brewed and sold iced tea. It brewed and bottled the iced tea in its fully-equipped manufacturing plant. It marketed the iced tea under its Peach & Ice Co brand name, selling its product to supermarkets, caterers and takeaway shops.

High production costs mean that Peach & Ice Co incurred large losses. The shareholder with majority ownership of Peach & Ice Co sold its stock to a new investor, causing Peach & Ice Co to fail the continuity of ownership test.

After the ownership change, Peach & Ice Co decided to cease production of iced tea and as a result sells its manufacturing plant and equipment.

Instead, Peach & Ice Co purchases bottled iced tea from another producer, which it distributes and resells. The iced tea no longer carries Peach & Ice Co's brand name. The business sells iced tea to a more limited subset of its previous customers, selling mainly to caterers and takeaway shops (but no longer to supermarkets). Peach & Ice Co becomes profitable and seeks to utilise its tax losses from before the change of ownership.

Peach & Ice Co would not satisfy the similar business test.

With regard to the first factor, to a significant extent, Peach & Ice Co's current business no longer generates assessable income from the assets that were used in the former business. The current business no longer generates income from using its Peach & Ice Co brand name (an intangible asset) on the label of its iced tea products. Likewise, the current business no longer generates assessable income from the processing plant and equipment. The predominant source of the current business's income is from sales of iced tea sourced from its new supplier.

With regard to the second factor, the source of the company's income changed substantially after the ownership change. The former business activities were the manufacture and wholesale distribution of iced tea. The current business income is sourced from the purchase and resale of another brand of iced tea. While Peach & Ice Co continues to generate income from the sale of iced tea there is a significant change to the operations and activities that are the source of the business's income in that it is now generating all of its income from reselling the iced tea, instead of from manufacturing it.

With regard to the third factor, the changes are changes that would have been expected of a similarly placed business, in that Peach & Ice Co has ceased the costly production element of its business and moved to reselling another brand of iced tea under a distributor license.

On balance, Peach & Ice Co would not satisfy the similar business test. Although it is still selling iced tea, this is outweighed by the significance of the change from the business producing its own unique brand of iced tea to reselling another brand of iced tea. Because of this, the company's current business is not a similar business to the former business.

This conclusion would likely be different if Peach & Ice Co continued to use its brand name on the label of its iced tea products and continued to sell its products to all of its previous customers.

Example 1.4: Similar business test failed

Bob's company runs a reputable homewares shop in a premises on a main street. However, Bob's business has made losses over a number of years.

Mary buys Bob's company (causing it to fail the continuity of ownership test). After working as manager of the homewares shop for a while, Mary decides to change it into a shop selling high-end stationery products and art supplies.

Mary has contacts who are stationery wholesalers and is able to negotiate favourable supply contracts with them. Mary also identifies a market for boutique stationery products and art supplies in the local area, and thinks she will be able to take advantage of the high pedestrian traffic of the location. Mary uses the brand name and logo of the homewares shop for the stationery business.

Mary's stationery and art supplies business is very profitable. She seeks to utilise the losses made on the homewares shop while Bob was running it.

This company would not satisfy the similar business test.

With regard to the first factor, the brand name and logo are assets that are used by both the current and former business to generate assessable income. The extent to which these assets were relevant to the derivation of income for the stationery business would be limited. While the goodwill's value would still have been influenced by the brand and trade mark, the extent to which the goods sold by the business has changed suggests that the goodwill would not be the same asset; it will likely be a new asset of a new business.

The business's premises is an asset that continues to be used after the ownership change. However, little weight would be given to this given that it is not central to the identity of either the former business or the current business.

With regard to the second factor, the extent to which the sources from which assessable income was generated after the ownership change was significant. The underlying activities, purchasing and retailing stationery and art supplies, are far removed from the homewares market. It is not sufficient for this factor that income continued to be generated from a business in the retail industry, or that income continued to be generated from customers who are residents of the local area.

Under the third factor, it could be argued that commencing a business selling stationery is a natural and predictable move for Mary because of her contacts in that industry. However, this falls outside of the hypothetical similarly-placed business that this factor considers. The particular connections and skills of the business's owner and manager are not considered as part of the 'similarly placed business' in the hypothetical test.

The fact that the business has premises in a high pedestrian area where there is a demand for high-end stationery products and art supplies would be considered as part of the factor. However, these features are insufficient to cause a reasonable person to expect a similarly placed business with these features to change from selling homewares to selling stationery and art supplies.

Overall, the continued use of the same premises and brand name and the fact that the business has taken up a profitable opportunity are not sufficient to outweigh the significant change to the business's identity and to the activities that are the source of its income.

The business continuity test period and the test time

1.32 To satisfy the similar business test, a company must carry on a business throughout the 'business continuity test period' (the current business), and it must be a similar business to the business it carried on immediately before the 'test time' (the former business). ***[Schedule 1, items # and #, subsection 165-211(1) of the ITAA 1997, subsection 269-105(1) in Schedule 2F to the ITAA 1936]***

1.33 In a basic case of carrying forward tax losses, the company would satisfy the similar business test if it carries on a similar business throughout the recoupment year (the 'business continuity test period') as it carried on immediately before it failed the continuity of ownership test (the 'test time').

1.34 The similar business test is available to be used for the same purposes that the same business test is currently used. For each of these purposes, individual provisions specify the 'business continuity test period' and 'test time' for which the similar business test must be satisfied. The 'business continuity test period' is equivalent to the 'same business test period' under the current law.

1.35 The test times and test periods that apply for the similar business test are identical to those that apply for the same business test: they are not changed by this measure.

Changes to the business made in contemplation of a change in ownership or control

1.36 The similar business test includes an integrity provision to counteract changes to the business that are made prior to and in contemplation of a change in ownership or control for purposes that include being taken to satisfy the similar business test. This is based on the equivalent provision in the same business test (subsection 165-210(3) of the ITAA 1997), which prevents these contrived changes from being made. ***[Schedule 1, items # and #, subsection 165-211(3) of the ITAA 1997 and subsection 269-105(4) in Schedule 2F to the ITAA 1936]***

Use of company's tax losses or deductions to avoid income tax

1.37 This measure switches on the integrity rules in Division 175 of the ITAA 1997 for losses, net capital losses, and bad debts when the similar business test is applicable. These integrity rules prevent tax avoidance or income injection schemes that seek to use a company's tax losses or deductions. This allows the objective of encouraging business innovation to be met without opening the way for tax avoidance schemes. ***[Schedule 1, items # and #, subsections 175-5(3), 175-40(3), 175-80(3) of the ITAA 1997]***

1.38 Subdivision 175-A of the ITAA 1997 contains two integrity rules that prevent income injection schemes. The Commissioner may disallow a loss:

- if an amount is injected that would not have been injected if the loss had not been available (section 175-10 of the ITAA 1997); or
- if a person obtains a tax benefit in connection with a scheme, and the scheme would not have been entered into or carried

out if the loss had not been available (section 175-15 of the ITAA 1997).

1.39 Similar rules are contained in Subdivision 175-CA of the ITAA 1997 (with respect to unused net capital losses) and Subdivision 175-C of the ITAA 1997 (with respect to unused bad debt deductions).

1.40 These rules did not apply when the same business test was satisfied. This is because the negative limbs of the same business test (the new transaction test and the new business test) cover the same ground as the income injection integrity rules. These negative limbs are removed for the new similar business test, to allow companies to legitimately enter into new lines of business without losing access to losses. Switching on the integrity rules in Division 175 of the ITAA 1997 will ensure that the removal of these negative limbs does not open the way to tax avoidance or income injection schemes to minimise a company's tax.

Example 1.5: Integrity rules

Jones controls the Jones Family Trust as the sole director of the corporate trustee. The Jones Family Trust derives income from a range of activities. The trust has recently experienced an increase in its profits.

Jones buys Jewellery Co, a company that carries on a jewellery retail business. The company has large tax losses from previous years. The company is made an object of the Jones Family Trust and Jones, as director of the corporate trustee, resolves to appoint income to Jewellery Co. The appointed income is not a material amount of Jewellery Co's income in each income year. However, over time Jones reduces the overall income tax payable by his controlled entities by a large amount.

Jewellery Co has never been the beneficiary of a trust previously. As Jewellery Co has derived income from a transaction of a kind into which it had not entered before the change of ownership, it would fail the same business test because of the new transactions test in section 165-210 of the ITAA 1997. However, given the limited extent to which the assessable income of Jewellery Co is derived from new sources, Jewellery Co is likely to satisfy the similar business test (as no other changes have taken place to Jewellery Co within the business continuity test period).

However, the income injection test in Subdivision 175-A will apply to disallow the tax losses of Jewellery Co. This is because Jewellery Co derived assessable income, being the income appointed by Jones to it as an object of the Jones Family Trust, which it would not have derived had the tax losses not been available.

The parallel similar business test for listed widely-held trusts

1.41 This measure will also supplement the parallel same business test for listed widely held trusts in Schedule 2F to the ITAA 1936 with a parallel similar business test.

1.42 This parallel similar business test for listed widely held trusts operates in the same way as the similar business test for companies. The parallel similar business test requires consideration of the same factors as the similar business test for companies. The mere fact of being a trust does not mean that the trust cannot carry on a business. ***[Schedule 1, item #, subsections 269-105(1) to (4) in Schedule 2F to the ITAA 1936]***

1.43 The parallel similar business test operates for the same purposes as the parallel same business test operates.

Consequential amendments

1.44 This measure introduces a new term: 'business continuity test', which encompasses both the same business test and the similar business test. The ITAA 1997 contains a number of references to the 'same business test'. The references to 'same business test' are replaced with references to the 'business continuity test'. These references lead to Subdivision 165-E which contains the rules for working out whether the same business test or both the same business test and the similar business test are applicable. ***[Schedule 1, items # and #, sections 4-15, 25-35, 36-25, 102-30, 165-5, 165-10, 165-13, 165-15, 165-23, 165-35, 165-40, 165-45, 165-93, 165-99, 165-102, 165-115, 165-115AA, 165-115B, 165-115BA, 165-117, 165-120, 165-126, 165-129, and 165-132, heading to Subdivision 165-E, sections 165-210, 165-212D, 166-5, 166-20, 166-40, 175-5, 175-40, 175-80, 701-5, 707-125, 707-135, 707-210, 707-400, 709-215, 715-15, 715-50, 715-55, 715-60, 715-70, 715-90, 715-95, 715-355, 715-360, 719-260, 719-265, 719-285, and 719-455, definitions of 'business continuity test' and 'same business test' in subsections 995-1(1) of the ITAA 1997]***

1.45 Some references to the 'same business' are replaced with references that encompass both the same business and similar business tests. ***[Schedule 1, items # and #, sections 165-30 and 707-120 of the ITAA 1997]***

1.46 The ITAA 1997 also contains a number of references to the 'same business test period'. Different same business test periods are set by different provisions. References to the 'same business test period' are replaced with references to the 'business continuity test period', so that those periods can apply in relation to both the same business test and the similar business test. The timeframes covered by the same business test periods are unchanged by this measure. ***[Schedule 1, items # and #, sections 165-13, 165-15, 165-35, 165-40, 165-45, 165-115BA, 165-126, 165- 129, 165-132, 165-210, 166-5, 166-20, 166-40, 415-35, 415-40, 707-125, 707-400, 715-50,***

715-55, 715-60, 715-70, 715-95, 715-355, 715-360, 719-260, and 719-265, definitions of 'business continuity test period' and 'same business test period' in subsection 995-1(1) of the ITAA 1997]

1.47 References to the 'same business test' and 'same business test period' in Schedule 2F to the ITAA 1936 are also replaced with references to the 'business continuity test' and the 'business continuity test period'. ***[Schedule 1, items # and #, sections 266-125, 266-135, 268-20, 269-5, heading to Subdivision 269-F, and sections 269-100, 272-140 in Schedule 2F to the ITAA 1936]***

Application and transitional provisions

1.48 The amendments apply in relation to income years starting on or after 1 July 2015.

When does the new similar business test apply?

1.49 The similar business test applies for income years beginning on or after 1 July 2015 in the way outlined in the specific provisions for each purpose for which it applies (described below). ***[Schedule 1, items # and #, subsection 165-211(1) of the ITAA 1997, subsection 269-105(1) in Schedule 2F to the ITAA 1936]***

1.50 Where the similar business test applies, a company may choose to instead apply the same business test. Although the similar business test is generally easier to satisfy, there may be administrative reasons for which the company may choose to apply the same business test. For example, if a company has losses to which the same business test applies and losses to which the similar business test applies, the company may find it more convenient to apply the same business test to all of its losses.

Tax Losses

1.51 The new similar business test applies with respect to tax losses incurred by companies for income years (loss years) beginning on or after 1 July 2015. The company may choose to apply the same business test or the similar business test. ***[Schedule 1, item #, paragraph 165-211(1)(a) of the ITAA 1997]***

1.52 When a company seeks to carry forward tax losses from previous years, tax losses incurred for income years beginning before 1 July 2015 will still only be able to be utilised if the same business test is satisfied with respect to those losses.

Capital losses

1.53 The new similar business test applies with respect to net capital gains and net capital losses made for income years beginning on or after 1 July 2015. For such losses, the company may choose to apply the same business test or the similar business test. ***[Schedule 1, item #, paragraph 165-211(1)(c) of the ITAA 1997]***

1.54 The same business test continues to apply with respect to net capital losses made for income years beginning before 1 July 2015.

Rules in Subdivision 165-CC

1.55 Subdivision 165-CC deals with situations where a company makes a capital loss (or a revenue loss in relation to a CGT event) on CGT assets or trading stock that it held from before a change of ownership.

1.56 Currently, unless the company satisfies the same business test, it cannot utilise the capital, revenue or trading stock losses to the extent of the company's unrealised net loss at the time of the changeover.

1.57 Subdivision 165-CC deems the capital loss (or the CGT event-related revenue loss) to be a net capital loss or tax loss in the income year *immediately before* the income year in which the changeover time occurred (subsections 165-115B(1) and (2) of the ITAA 1997). Where that income year immediately before the one in which the changeover time occurred is an income year beginning on or after 1 July 2015, the same business test or the similar business test may be applied to determine whether those losses can be utilised. ***[Schedule 1, item #, paragraphs 165-211(1)(a), (c) and (d) of the ITAA 1997]***

Rules in Subdivision 165-B and 165-CB

1.58 In applying to tax losses and taxable income for income years beginning on or after 1 July 2015, the new similar business test applies to tax losses and taxable income worked out under Subdivision 165-B. This means that the similar business test applies to income years beginning on or after 1 July 2015 for the purposes of the special method in Subdivision 165-B for working out a company's tax loss and taxable income for an income year in which the company has undergone a change of ownership or control. ***[Schedule 1, item #, paragraphs 165-211(1)(a) and (b) of the ITAA 1997]***

1.59 In applying to net capital gains and net capital losses for income years beginning on or after 1 July 2015, the new similar business test applies to working out net capital gains and net capital losses under Subdivision 165-CB. This means that the similar business test applies to income years beginning on or after 1 July 2015 for the purposes of whether and how the special method in Subdivision 165-CB for working out a company's net capital gain and loss for the income year in which the company has undergone a change of ownership or control. ***[Schedule 1, item #, paragraph 165-211(1)(c) of the ITAA 1997]***

1.60 For such income years, the company may choose to apply the same business test or the similar business test.

Bad debts

1.61 For the purposes of determining whether a debt written off as bad can be deducted, the new similar business test applies with respect to debts incurred in income years beginning on or after 1 July 2015. For such debts, the company may choose to apply the same business test or the similar business test. ***[Schedule 1, item #, paragraph 165-211(1)(c) of the ITAA 1997]***

Example 1.6: Timing for bad debt deductions

Creditry Co incurs a debt in the 2013-14 income year. It undergoes a change of ownership in the 2016-17 income year, failing the continuity of ownership test. Creditry Co writes off the debt as bad in the 2017-18 income year.

To obtain a deduction for the bad debt in the 2017-18 income year, Creditry Co must satisfy the *same business test*. This is because the debt was incurred in an income year beginning before 1 July 2015.

Creditry Co satisfies the same business test, and is able to obtain a deduction for the bad debt that it has written off for the 2017-18 income year.

Creditry Co makes a loss in the 2017-18 income year. The deduction for the bad debt forms a part of this loss.

Creditry Co undergoes another change of ownership that causes it to fail the continuity of ownership test again. It then makes a large profit in the 2019-20 income year and seeks to utilise its loss from the 2017-18 income year.

Because this loss is for an income year beginning on or after 1 July 2015, Creditry Co can utilise this loss if it satisfies the *similar business test*. This includes the part of the loss that resulted from the deduction of the bad debt.

However, Creditry Co may choose to apply the *same business test* in working out whether it can utilise losses for the 2017-18 income year if this is more convenient for the company. For example, if Creditry Co can show that it carried on the same business since at least the test time that had to be applied for the bad debt, then it may be administratively easier to apply the one test rather than to apply both the same business test and the similar business tests.

Consolidation – losses transferred from a joining entity

1.62 Section 707-140 of the ITAA 1997 treats a loss transferred from a joining entity to a head company as having been made by the head company in the income year in which the transfer happens.

1.63 A specific provision modifies section 707-140 to prevent the new similar business test from being applied to losses that were originally incurred for income years beginning before 1 July 2015. Without this provision, a loss actually incurred in an income year beginning before 1 July 2015 could be transferred to a head company in an income year beginning on after 1 July 2015 and would be a loss eligible to be recouped by the head company using the new similar business test. ***[Schedule 1, item #, subsection 707-140(1A) of the ITAA 1997]***

Listed widely held trusts

1.64 For listed widely held trusts, the parallel similar business test in Schedule 2F of the ITAA 1936 applies with respect to:

- a tax loss for a loss year starting on or after 1 July 2015; ***[Schedule 1, item #, paragraph 269-105(1)(a) in Schedule 2F to the ITAA 1936]***

- the working out of net income and tax losses for an income year starting on or after 1 July 2015 for the purposes of Division 268 in Schedule 2F to the ITAA 1936; and ***[Schedule 1, item #, paragraph 269-105(1)(b) in Schedule 2F to the ITAA 1936]***

- with respect to the writing off of bad debts, a debt incurred in an income year starting on or after 1 July 2015. This includes debts that are extinguished by a debt/equity swap, where the debt is incurred in an income year starting on or after 1 July 2015. ***[Schedule 1, item #, paragraphs 269-105(1)(c) and (d) in Schedule 2F to the ITAA 1936]***

1.65 Where the similar business test applies, a listed widely held trust may choose to instead apply the same business test. Although the similar business test is generally easier to satisfy, there may be administrative reasons for which the listed widely held trust may choose to apply the same business test.