Business Tax Working Group

Interim report on the tax treatment of losses

© Commonwealth of Australia 2011

ISBN 978-0-642-74775-4

This publication is available for your use under a Creative Commons Attribution 3.0 Australia licence, with the exception of the Commonwealth Coat of Arms, the Treasury logo, photographs, images, signatures and where otherwise stated. The full licence terms are available from http://creativecommons.org/licenses/by/3.0/au/legalcode.

Use of Treasury material under a Creative Commons Attribution 3.0 Australia licence requires you to attribute the work (but not in any way that suggests that the Treasury endorses you or your use of the work).

Treasury material used 'as supplied'

Provided you have not modified or transformed Treasury material in any way including, for example, by changing the Treasury text; calculating percentage changes; graphing or charting data; or deriving new statistics from published Treasury statistics — then Treasury prefers the following attribution:

Source: The Australian Government the Treasury

Derivative material

If you have modified or transformed Treasury material, or derived new material from those of the Treasury in any way, then Treasury prefers the following attribution:

Based on The Australian Government the Treasury data

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are set out on the It's an Honour website (see www.itsanhonour.gov.au)

Other Uses

Inquiries regarding this licence and any other use of this document are welcome at:

Manager
Communications
The Treasury
Langton Crescent Parkes ACT 2600
Email: medialiaison@treasury.gov.au

TABLE OF CONTENTS

Table of Contents iv
Executive summary v
Background 1
Introduction 1
Structure 2
1. A changing economy 5
1.1. Business decision making 5
1.2. Decision making and tax 6
2. Tax treatment of losses 7
2.1. Objectives of the tax treatment of losses 7
2.2. Current tax treatment of losses 9
2.3. The implications of the current treatment of losses 11
3. Possible approaches to reform 15
3.1. Element A — remove COT and SBT 16
3.2. Element A — alternative integrity test 18
3.3. Element B — loss refundability 19
3.4. Element C — time limited loss carry back 20
3.5. Element D — applying an uplift factor 22
3.6. Possible combinations of elements 24
3.7. Scope of tax losses to which the new rules would apply 26
4. Other reform elements — black hole provisions 29
4.1. The black hole provisions 29
4.2. Relevance to business decision making 29
4.3. Possible approaches to reforming the black hole provisions 29
5. Conclusion 31
APPENDIX A 33
Business Tax Working Group — Membership and terms of reference 33
Membership 33
Terms of reference 34
APPENDIX B 37
Tax treatment of losses by country 37

EXECUTIVE SUMMARY

Australia's economy and the global economic environment have changed dramatically over the past 10 years. Now, against the backdrop of an economy undergoing structural change, it seems appropriate that the Government looks at addressing barriers within the business tax system to businesses' ability to adapt and change.

Australian businesses will need to be responsive to make the most of the opportunities that are available and be flexible to cope with the volatile economic environment. This will contribute to the re-shaping of Australia's economy, allowing businesses to break into new niche markets and regions, and build on existing and develop new comparative advantages. Responsiveness will rest on businesses' ability to take risks and to restructure and grow through accessing innovation, technology and a skilled workforce. It is important that all policy settings, including tax, are designed so as not to hinder such risk taking and innovation.

The Business Tax Working Group (the Working Group) has been tasked with advising the Government on how the business tax system can be improved to enable business to make the most of the challenges and opportunities arising from transformations in the broader economic environment.

The Working Group's interim report on the tax treatment of losses (the report) canvasses potential reforms to the tax treatment of losses that are designed to increase productivity, while also delivering tax relief to struggling businesses. The Working Group will consider these reform elements against the broader context of other desirable longer-term reforms to the business tax system. Whether the Working Group is able to recommend any of these reforms in its final report will require further consideration (including identification of offsetting savings).

The tax treatment of losses

Most governments, including Australia's, do not pay the income tax value of losses to taxpayers on an accruals basis. This is an asymmetric treatment where taxpayers pay tax to the Government on positive taxable income but the Government does not make payments to taxpayers reflecting negative taxable income. Although the Government does not 'cash out' tax losses, in certain circumstances it currently allows tax losses to be carried forward to be deducted against assessable income in future years.

Any losses carried forward to be deducted against future assessable income are subject to integrity rules which further restrict the access to losses where there is a substantial change in company ownership and the type of activity undertaken by the business. These rules can lead to losses being 'trapped' or never able to be used. In some regards, trapped losses represent a windfall gain for governments.

The asymmetric tax treatment of losses creates a bias against risk-taking in the economy because the tax paid by the company as a proportion of its taxable income (its effective tax rate) can exceed the statutory rate of 30 per cent if losses are incurred. The higher the level of loss accumulation as compared with income generation and loss utilisation, the higher its effective tax rate will be.

This report also highlights that the current treatment of losses restricts business cash flow, which in turn reduces the ability for business to invest and can impact on its ability to access debt and equity. These impediments to risk taking, investment and innovation impose a cost on the economy through detracting from productivity growth. This impact is heightened in the current economic conditions when a higher commercial premium attaches to a company's ability to respond and adapt to a volatile environment.

Balancing competing objectives

The overarching objective of the business tax system is to raise revenue to fund the provision of Government goods and services while minimising the impact tax has on investment and production decisions. The integrity of the tax system is important to ensuring that the right amount of tax is paid and business decision-making is not distorted towards achieving a certain tax outcome (including minimising a tax liability). Reforming the tax treatment of losses involves striking an appropriate balance between these objectives.

The different reform elements canvassed in this report need to be assessed on the basis of their impact on the Government's ability to raise revenue, the extent to which they lessen the tax distortion introduced to business decision making and the extent to which they preserve the integrity of the tax base.

This report sets out four possible reform elements, which could be pursued individually or in combination: replacing the current integrity rules restricting access to losses; allowing immediate loss refundability; allowing losses to be carried back and offset against previous years' profits; and allowing losses carried forward to be uplifted by a determined benchmark rate.

The provision of immediate loss refundability would overcome the asymmetries and distortions outlined above. However, the Working Group has noted that immediate refundability will involve a significant cost to revenue and for the purposes of this report immediate loss refundability is not proposed as a viable reform for the foreseeable future. Nonetheless, proposed reform elements outlined in this paper are assessed against the benchmark of immediate loss refundability, which theoretically provides perfectly symmetrical treatment of profits and losses.

Next steps

While it is not proposed to use the tax system as the primary tool to respond to the economy in transition, the Working Group recognises that there are weaknesses in the tax system that exacerbate some of the current challenges facing business. The Working Group also recognises that some competitor countries have different approaches to the tax treatment of losses and we should aim to keep pace with these developments.

On the basis of the initial analysis undertaken, the Working Group considers that there is merit in undertaking further consideration of reforms to the tax treatment of losses as the business tax system could assist businesses respond to structural change within the economy. The Working Group will assess the merit of the changes against other potential changes to the business tax system that have the potential to boost productivity growth.

As outlined in the Working Group's terms of reference, the costs of any reform options will need to be offset by savings from business taxation measures to achieve a revenue neutral package. In considering the costs and benefits of any changes to the tax treatment of losses as part of the Final Report, the Working Group will also assess the impact of savings options to ensure that the overall impact of the package is worthwhile.

Further analysis and broad consultation will be conducted before making final recommendations on the reform options for the tax treatment of losses. The Working Group intends to use this interim report as the basis for its consultations.

Background

1. On 5 October 2011, the Treasurer announced the establishment of the Business Tax Working Group (Working Group) as part of his closing address to the Tax Forum. The Working Group's membership and terms of reference are provided at Appendix A.

2. The Working Group will look at how the business tax system can be improved to allow businesses to respond to emerging challenges and take advantage of new opportunities presented by changes in Australia's economy and developments internationally.

3. The focus of the Working Group's interim report is the tax treatment of losses. A final report on the treatment of losses will be provided to the Treasurer in March 2012. The Working Group is also required to provide a report on longer-term business tax reform directions by the end of 2012.

Introduction

4. The global economic landscape presents both opportunities and challenges for the Australian economy. The resource intensity of Asia's re-emergence has boosted the demand for, and the price of, Australia's mineral and energy resources to the point where we are now experiencing a sustained increase in our terms of trade.

5. While some businesses clearly stand to benefit from the strength of the terms of trade, others are facing challenges from the resulting exchange rate pressures. In addition to this, the global economic environment continues to bear the lingering effects of the global financial crisis, together with the recent effects of the volatility of financial markets in Europe.

6. Despite rapid growth in living standards, China and India are poised to significantly increase their economic footprint. Rising incomes in these economies will see changing food consumption patterns, and increased demand for luxury and durable consumer goods and services. These changes present new opportunities for Australian businesses.

7. Australian businesses will need to be responsive in this economic environment if they are to make the most of these opportunities and remain flexible in a volatile environment. The responsiveness of businesses to break into new niche markets and regions, and build on existing comparative advantages, will potentially re-shape Australia's economy. This responsiveness will rest on businesses' ability to make effective decisions to take risks, restructure and grow through innovation, technology and a skilled workforce. It is important that all policy settings, including tax, are designed so as not to hinder such activity.

8. In this context, the Working Group is examining the extent to which rules in the business tax system may hamper Australian businesses' ability to respond to these challenges and opportunities. Where such rules exist they should be reassessed to ensure that they continue to be of overall economic benefit.

9. In particular, the Working Group has been asked to focus initially on options for reforming the tax treatment of losses. Most governments, including Australia's, do not pay the income tax value of losses to taxpayers on an accruals basis. This creates an asymmetric tax treatment of profits and losses where taxpayers pay tax to the Government on positive taxable income but the Government does not make payments to taxpayers reflecting an amount of negative taxable income. This can be contrasted with the GST, where the Government will refund to taxpayers the amount of input GST that exceeds output GST.

10. This report explores how this asymmetric treatment of profits and losses distorts taxpayer decision-making, which magnifies economic costs, particularly in terms of risk taking.

11. The asymmetric tax treatment of profits and losses results in businesses in a loss position being unable to gain tax relief from their deductions in the same way that a business in profit does. Restrictions on the utilisation of losses decrease the cash flow of businesses in a loss position even where they may have previously been profitable. These restrictions provide greater benefits to taxpayers who can immediately deduct losses against profits in other business areas or projects.

12. Given these issues, one of the objectives of the reform elements considered by the Working Group is to reduce the impact of the treatment of losses on business decision making, thereby reducing the bias against riskier investments and, at the same time, improving the cash flow for struggling businesses. However, this objective will need to be balanced against the objective of ensuring that an appropriate amount of tax is paid and the objective of preserving the integrity of the tax base.

13. Further analysis and consultation will be required before the Working Group provides its final recommendations on the reform options for the tax treatment of losses. However, the Working Group's interim conclusion is that the tax treatment of losses merits further consideration. The costs and benefits of recommended reforms to the tax treatment of losses will however, also be considered in the broader context of other longer-term reforms to the business tax system to maximise the productivity benefits of any changes.

14. Distributional effects, transitional paths and the sustainability of reforms over time will be important factors for the Working Group to consider. In line with the Working Group's terms of reference, any recommendations involving a cost to the Budget will need to be funded from within the business tax system. In considering the costs and benefits of reform of the treatment of losses, the Working Group will also assess the impact of savings options to ensure that the overall impact of the package is worthwhile.

Structure

15. This interim report describes the kinds of decisions facing Australian businesses in responding to the current economic environment. It also considers the impact the tax treatment of losses is having on these decisions, some areas where reform could be considered, and possible approaches to reform.

16. The terms 'business' and 'company' are used interchangeably throughout the paper and should be taken to mean a business operating through a company structure. The application of the reform options outlined in this paper to businesses operating through other structures (such as sole traders, partnerships and trusts) will require further analysis.

17. This report contains the following sections:

> **Section 1** — sets out the kinds of decisions Australian businesses are facing in the current economic environment and the implications this has for Australia's productivity performance and ability to respond to structural change;
>
> **Section 2** — discusses how the treatment of tax losses has evolved over time and how the current restrictions on loss utilisation may influence business decision making;
>
> **Section 3** — explores possible options for reform in the treatment of losses including some of the potential benefits, risks and outcomes involved;

Section 4 — outlines the possible options for improving the operation of the black hole provisions, which apply to certain expenditures associated with restructuring, closing or starting a business; and

Section 5 — concludes.

1. A CHANGING ECONOMY

18. Now more than ever, Australia's growth prospects are linked to the resources sector and our linkage to fast-growing Asian economies. The exchange rate pressures associated with the sustained strength of Australia's terms of trade is placing a strain on the trade-exposed sectors of the Australian economy. Further, the outlook for the global economy remains uncertain with the risks to global financial stability flowing from the European debt crisis intensifying and continuing financial market volatility. The economic environment presents both challenges and opportunities for Australian businesses.

19. A time of structural change within the economy will encourage the ingenuity of Australian businesses in finding new ways to combine technology, a skilled workforce and new ideas to produce more for each unit of capital and labour — that is, continued productivity growth. Taking up business opportunities may require labour and capital to work together in new innovative ways (contributing to multifactor productivity). New investment may also occur, thereby contributing to capital deepening. Decisions by businesses about adapting and innovating are therefore crucial to productivity growth. It is important that all policy settings, including tax, are designed so as not to hinder such activity related to productivity.

1.1. Business decision making

20. Australian businesses will need to be responsive in the current economic environment to make the most of major opportunities and remain flexible given the volatile economic environment. This responsiveness rests on businesses' ability to make effective decisions to take risks, restructure and grow through innovation, technology and a skilled workforce.

21. How each individual business adapts or responds to the changing economic environment will be different. However, a process of change across the economy would be expected to involve businesses undertaking the following kinds of activities:

- Exploring new business opportunities.
  - Businesses may commission a feasibility study to determine if a new venture is viable. External advisers may need to be employed to provide a fresh perspective on the business and advice on possible strategies for improving performance.
  - Businesses may invest in research and development (R&D).
  - New companies (or other structures) may also be established to provide an institutional form for a new business venture.
- Restructuring to adopt new strategies.
  - To implement a new business strategy may require new machinery and equipment. Existing staff may need to be retrained and new staff may need to be employed to bring in new skills and expertise.
  - Businesses may acquire or merge with other businesses to achieve economies of scale or access to intellectual property and know how.

- To fund these activities, businesses may need to refinance existing debt or obtain new sources of finance. A business may also decide to sell off parts of its operations that are no longer viable or are simply inconsistent with the new strategy.
- Revenues during the restructuring period may be less than in previous years, while costs may be higher.

- Expanding to take advantage of opportunities.
  - Expanding to take advantage of opportunities may involve expanding existing production capacity, acquiring new technology to achieve efficiency gains and retraining existing staff. This expansion may involve a temporary spike in costs, possibly before revenue from any new ventures starts to flow.
- Ceasing current operations or sale of the business.
  - For some businesses, now may be the right time to start the process of shutting down some of its operations.
  - Business owners may decide that they can optimise value in their business for shareholders and employees by selling the business to another entity that is better able to run the business.
  - Acquirers of existing businesses will determine the value of any tax losses based on rules relating to the nature of the business being carried on when losses were generated and when they may be utilised.
- Enduring a period of short-term shocks.
  - Where a business makes an informed decision that an economic shock will be of short duration, it may elect to find ways of enduring without significantly modifying the nature of the business.

1.2. Decision making and tax

22. All of the above activities interact with the tax system — through the deductions available for expenses incurred and the recognition of income generated.

- For example, where businesses need to undertake a large amount of upfront investment in order to take up a new opportunity, they are more likely to end up in a tax loss situation (assuming their income remains the same as, or is lower than, recent past years). As discussed below, the ability of businesses to realise the value of this tax loss can impact on their investment decisions.
- The deductibility of costs associated with starting up a new business, changing an existing business model or structure or closing down an existing business will also impact on businesses' decision making.

23. Decisions such as these are contemplated by businesses on an ongoing basis. However, in an economy undergoing structural change, businesses may be required to contemplate these decisions more regularly and in a more risky environment. In order for the economy to grow there needs to be businesses investing in new or expanding activities and taking risks. It is therefore increasingly important that the tax system does not impose barriers to businesses adapting and changing in response to the current economic environment or encourage businesses to pursue or maintain sub-optimal strategies.

2. Tax treatment of losses

24. The business tax system taxes net income (that is, assessable income less allowable deductions) in the year they are derived. A perfectly symmetrical treatment of losses would require a portion of a loss to be refunded in the year the loss is incurred (that is, a cashing out of tax losses).[1]

25. The income year is an artificial construct to separate time into increments. The tax law requires a business to account for its financial position over this designated increment of time, which simply provides an annual snapshot of the businesses financial position. A tax loss arises where a taxpayer's allowable deductions exceed their assessable income for a particular income year (that is, they have negative taxable income).[2] In this case, a taxpayer is unable to utilise deductions for expenses (including previous tax losses) that they have validly incurred, because they have insufficient assessable income in that income year to absorb them.

26. This highlights the fact that businesses that incur a loss in a particular income year (because they have insufficient assessable income to absorb their allowable deductions) suffer the asymmetric treatment of losses, notwithstanding the fact that the business may not have incurred a loss over a longer time frame or a different snapshot in time.

27. Certain business decisions will be influenced by the timing of the income year. However, business cycles and changes in the broader economic environment will not necessarily coincide with the income tax year. Over time, the tax system has evolved to allow tax losses in one income year to be carried forward and offset against income in a future income year, subject to integrity measures.

28. To be economically neutral, investments with the same expected net present value should be subject to the same effective rate of company income tax. However, the combined impacts of requiring business to reconcile their tax position over an arbitrary time period (the income tax year); the asymmetric tax treatment of losses and profits; and the integrity rules, mean that investments with the same expected net present value can be currently taxed quite differently, with effective tax rates[3] potentially exceeding statutory rates.

29. This section sets out the objectives behind the current tax treatment of losses, explains the current tax treatment of losses and highlights the implications for decision making in an economy undergoing structural change.

2.1. Objectives of the tax treatment of losses

30. The overarching objectives of the business tax system are to raise revenue to fund the provisions of Government goods and services and at the same time minimise the impact tax has on investment and production decisions. The integrity of the tax system is important to ensuring that the right amount of tax is paid and that business decision making is not distorted by seeking to achieve a certain tax outcome (including minimising a tax liability).

31. There are two reasons typically cited for not allowing immediate refundability for tax losses (that is, cashing out tax losses): namely that it would reduce the amount of revenue raised and may

1 To achieve pure symmetrical treatment, the portion of the loss refunded would need to equal the effective tax rate applicable to the investment. This may be the statutory company tax rate (currently 30 per cent), however, some companies are known to face lower effective tax rates due to other factors in the tax system, such as accelerated depreciation or the deferred realisation of gains.

2 Losses must first be applied against exempt income.

3 Effective tax rate means the amount of tax paid as a proportion of taxable income over time.

also encourage tax avoidance. It follows that the asymmetric tax treatment of profits and losses reduces both the risks to Government revenue and risks to the integrity of the tax base.

2.1.1 Risks to revenue

32. Restricting the utilisation of losses has the effect of increasing the net present value of tax revenue to the Government. Increasing the ability for companies to utilise losses would be likely to have the effect of reducing the net present value of tax revenues to the Government and potentially increasing the volatility of Government revenues, which would impact on its ability to manage its year-to-year budget.

2.1.2 Risks to the integrity of the tax base

33. The tax avoidance rationale for placing restrictions on loss utilisation requires an understanding of the underlying policy 'mischief'. There are two aspects to consider: (a) whether the tax system can generally be relied on to prevent the creation of artificial deductions and (b) whether the transfer of legitimate losses is acceptable.

34. The first aspect to consider is whether the deductions that give rise to the loss are 'legitimate'. It is generally accepted that deductions need to be 'real' (as opposed to 'artificial') in order to be legitimate. Any opportunity to create artificial or duplicated tax losses would reveal a weakness in the tax base generally, irrespective of the loss integrity rules. For example, the loss restriction rules would have no effect where 'artificial' deductions are sheltered by the taxable income of companies in profit.

35. The second aspect to consider is the transferability of tax losses between taxpayers. A common argument against allowing unrestricted transfer of losses is that the benefit of a tax loss should only be captured by the taxpayer that economically bears the loss. This rationale is further explored below in the discussion of the current loss integrity rules. However, an offsetting consideration is that if a loss taxpayer 'sells' the tax value of its loss to another, it realises the value of its tax loss through the positive value paid by the acquirer for the value of the tax losses (which would contribute to taxable gains realised by the vendor). Equally, the buying taxpayer would be expected to claim the loss in its tax return (to the extent of any offsetting assessable income), thereby obtaining some of the loss value.

36. A further benefit of transferability is that the Government does not directly fund the cashing out of tax losses, albeit having an indirect impact on Government revenue as the transferred tax loss would be utilised. Further, although transferability provides the same economic outcome as refundability by the Government, it does so in a less transparent manner. A related potential tax avoidance issue is that if deductions could be artificially created, the ability to sell them would motivate their creation. There is also the tax revenue argument that transferability reduces the net present value of tax revenues to the Government, because of the potential future application of tax losses.

37. Finally, although tax avoidance concerns may provide some rationale for restricted loss use, the restrictions themselves may motivate taxpayers to engage in uncommercial business behaviour that may be influenced by tax outcomes to achieve future business viability.

2.2. Current tax treatment of losses

2.2.1 Losses can be carried forward to offset future income

38. The asymmetric tax treatment of profits and losses has been a feature of Australia's tax system for many years. Initially, losses could only be used to reduce income derived from real property. In 1922, amendments were made to the tax law to allow losses to be applied against all ordinary income. A four-year carry forward rule was introduced in 1927, which was expanded to seven years in 1947. The time restriction was removed completely in 1990 to allow losses to be carried forward indefinitely.

39. Where tax losses are carried forward into a future income year, their real value decreases as they are not indexed or uplifted over time. Further, a company may never be able to fully utilise its carry forward losses, either because of the application of loss integrity rules (discussed below) or because it never generates sufficient income (including because it ceases to carry on business).

40. The current law also creates a distinction between revenue gains and losses and capital gains and losses. The capital gains tax arrangements introduced in 1985 applies to realised gains and losses on assets acquired after 19 September 1985. Prior to 1985, Australia had no general tax on capital gains[4], with most capital gains excluded from the income tax base. Under the current law, capital losses can only be applied against capital gains, while revenue losses can be applied against revenue gains and capital gains (as a net capital gain forms part of assessable income).

41. At no point have tax losses been refundable in Australia. Tax losses are generally[5] not refundable in other jurisdictions.

42. Unlike some other countries, Australia does not allow tax losses to be carried back to offset taxes paid in previous income years. Canada allows tax losses to be carried back three years, the United States allows two years and Germany, Japan, the Netherlands, Singapore and the United Kingdom generally allow a one-year carry back. France has recently amended their tax law to reduce their three-year carry back to a one-year carry back capped at €1 million. Ireland generally allows a one-year carry back, but allows a three year carry back for loss making companies that are winding up.[6]

2.2.2 Loss utilisation is subject to integrity rules

43. A company's ability to utilise their carry forward losses to reduce taxable income in a future year is subject to long-standing integrity rules.[7]

44. The continuity of ownership test (COT) ensures that the economic owners of the company that incurred a loss are the same economic owners that are able to gain the benefit of the loss. In 1965 this test was amended by allowing companies that failed the COT to use their tax losses if they met the same business test (SBT). The SBT allows businesses carrying on the same business as the business that derived the losses to use the losses.

---

4 Some targeted capital gains taxes were in operation, the most important was that applying to gains from property held for less than one year, which was introduced in the early 1970s.

5 To the Working Group's knowledge, immediate refundability is not a feature of the tax system in other jurisdictions.

6 OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (2011). A more detailed comparison of the treatment of tax losses across OECD countries is provided at Appendix B.

7 The first continuity of ownership test (COT) was introduced for private companies in 1944. This test was modified and further extended to public companies in 1964. A same business test (SBT) was first introduced in 1965. In 1973 the COT and SBT were extended to also apply to the utilisation of bad debts.

45. The main policy rationales for restricting the use of a tax loss to the entity that derived the tax loss is Government revenue protection and integrity of the tax base. The rules prevent the practice of 'loss trading' whereby a company that is stripped of all of its assets, except its tax losses, is sold to another company (one company acquires 100 per cent of the shares in another company) with the view to immediately access the value of the tax loss embedded in the company. That is, the rules seek to address the scenario where there is no economic substance to the transaction other than gaining access to accumulated losses, potentially acquired at a discounted value.

46. There are also rules to prevent inter-entity 'loss multiplication'. Loss multiplication occurs where a group of companies benefit from a single economic loss more than once by artificially duplicating the loss through a chain of interposed entities. This could occur because the loss in the value of an entity is also reflected in the value of interests (such as shares) in that entity. Broadly, the rules operate by denying the capital loss that would otherwise have arisen on the transfer of the economic loss impacting on the share value of the interposed entities.

Current loss integrity rules

47. A company can deduct prior year tax losses, or apply net capital losses, only if it satisfies the COT or the SBT (section 165-10 of the *Income Tax Assessment Act 1997* (ITAA 1997)).[8]

48. The COT is satisfied if the same persons have more than 50 per cent of the company's voting power, rights to dividends and rights to capital distributions at all times during the ownership test period (section 165-12 of the ITAA 1997). The ownership test period is generally the period from the start of the income year in which the loss was incurred (the loss year) to the end of the year in which the loss is sought to be recouped (the claim year).

49. A company must trace ownership through to the ultimate beneficial owners of the shares in the company to determine whether the COT is satisfied. To reduce compliance costs, these rules are modified for widely held companies and certain other types of companies (Division 166 of the ITAA 1997).

50. The SBT allows companies to utilise tax losses where there has been a greater than 50 per cent change in beneficial ownership, but the company is carrying on the same business in the claim year as it carried on immediately before the test time (section 165-13 of the ITAA 1997). For these purposes, the test time is generally the time that the company failed the COT. However, if it is not practicable for the company to show when it has failed the COT, the test time is generally the start of the loss year.

51. In 2000 the inter-entity loss multiplication rules were introduced to restrict the duplication of losses within the tax system. These rules were designed to ensure that tax losses derived were economic rather than artificial losses.

52. The transfer of tax losses between members of the same wholly-owned group was allowed from 1984 until the introduction of the consolidation regime in 2002 when the transfer of tax loss rules were amended and restricted so that they only apply to transfers involving foreign bank branches and permanent establishment foreign financial entities. From 2002, when the tax loss rules for consolidated groups were introduced, non-consolidated wholly-owned groups, except for foreign bank branches, ceased to be able to use group losses against taxable income of other members of the same group.

53. Under the consolidation regime, there are special rules that apply to allow the joining entity to transfer unused tax losses to the head company of the group. In addition to the COT and SBT rules,

8 In certain situations, a company must also meet the control test in section 165-15 of the ITAA 1997.

an available fraction rule is applied to tax losses held by an entity that joins a consolidated group to ensure that the tax losses are able to be used by the head company of the consolidated group at approximately the same effective rate that they would have been used had the joining entity remained outside the consolidated group. This available fraction rule acts as an integrity measure to ensure that tax losses once brought within a consolidated group are not immediately accessed. This reduces the risk of entities being brought into the group purely to gain access to their tax losses and also spreads the utilisation of tax losses.

2.3. The implications of the current treatment of losses

2.3.1. The asymmetric tax treatment of profits and losses creates a bias against risk taking

54. The asymmetric tax treatment of profits and losses means that the Government takes a share of any profits a business makes but limits its exposure to any losses. Perfectly aligning the tax treatment of profits and losses would involve making losses refundable at the same rate and at the same time that profits are taxed.

55. By treating profits and losses asymmetrically the tax system imposes a higher effective tax rate (the tax paid by the company as a proportion of its taxable income) on investments where the probability of making a loss is positive. In this way, the tax system creates a bias against healthy risk taking that otherwise may be beneficial for the economy. An impediment to sensible risk taking may impact on businesses' ability to adapt and change and also stunt innovation and entrepreneurial activity occurring in the economy as it is those types of activities that are, by their very nature, more risky.

> For example, consider the two investment choices shown in Table 1 and Table 2. Investment 1 and investment 2 both have the same expected return before tax ($30), but the after-tax return for investment 2 ($15) is lower than for investment 1 ($21), because investment 2 is more risky and has a positive probability of producing a loss.
>
> Investment 1 involves a zero probability of making a loss, a 50 per cent chance of making $40 and a 50 per cent chance of making $20. The effective tax rate on such an investment is the prevailing statutory rate, assuming the business will pay 30 per cent of the before tax profits.[9] On the other hand, investment 2 has a 40 per cent chance of making a loss (20 per cent chance of making a loss of $60 and 20 per cent chance of making a loss of $40) but also provides the prospect of greater returns than under investment 1. If the business expects never to be able to utilise any losses incurred on investment 2, then the effective tax rate on that investment will be higher (50 per cent) than under investment 1 (30 per cent).

9 The example assumes a 30 per cent statutory company tax rate, noting that an announcement has been made by the Government to reduce the rate to 29 per cent from the 2013-14 income year.

Table 1: Impact of tax on less risky investment choice

Possible before-tax return on an investment ($)	Investment 1 (less risky)			
	Prob. of return (%)	Before-tax expected return ($)	After-tax expected return ($)	Effective tax rate (%)
40	*50*	20	14	30
20	*50*	10	7	30
Total		**$30**	**$21**	**30%**

Table 2: Impact of tax on more risky investment choice

Possible before-tax return on an investment ($)	Investment 2 (more risky)			
	Prob. of return (%)	Before-tax expected return ($)	After-tax expected return ($)	Effective tax rate (%)
120	*10*	12	8.4	30
100	*20*	20	14	30
80	*20*	16	11.2	30
20	*10*	2	1.4	30
-40	*20*	-8	-8	-
-60	*20*	-12	-12	-
Total		$30	$15	**50%**

56. While this is a stylised example, there are a range of possible real world applications of this investment choice. For example, investing in new, more technologically advanced equipment in order to expand a product line is considered to be a more risky investment than continuing to service existing equipment that is tried and tested. Similarly investing in initially expenditure-intensive projects can result in long term distortions of effective tax rate.

57. Reducing the asymmetry in the tax treatment of profits and losses would bring the effective tax rates on investments involving higher risk (or higher initial expenditure) closer to the prevailing statutory rate and thereby increase the expected after tax return on such investments. This would not only increase the quantity of investment in the economy (since more investments would be likely to meet internal hurdle rates), but also the quality of investment taking place (since investment choices should be less distorted by the tax system). Increasing the quantity and quality of investment would improve the allocation of resources across the economy and have positive flow-on effects for productivity. Higher productivity can in turn support growth in real wages and employment.

58. Conceptually, the case for a more symmetrical tax treatment of losses could be made at any point in the business cycle. However, it is arguably even more important in an economy undergoing structural change where businesses are likely to be required to contemplate new investments, or divesting non-viable investments as part of responding to new challenges and taking up new

opportunities. While perfectly aligning the tax treatment of profits and losses would remove the current bias against risk taking in the economy, it would make the business tax base a more volatile source of revenue. That is, by increasing any fiscal exposure to company losses, the Government would be accepting a greater share of the risk involved in doing business in Australia. The need to trade off the benefits and risks of improving the tax treatment of losses may therefore decrease, but not totally ameliorate, the asymmetric tax treatment of profits and losses.

59. Treating losses differently to profits is a common feature of tax systems around the world.[10] One of the common international reasons for this approach is the impact that immediate refundability would have to increase the volatility of the revenue base. In addition, unilaterally providing a perfectly symmetrical treatment of losses may be expected to attract additional generation or utilisation of tax losses in Australia, imposing a substantial cost on the Budget.[11] Such a cost would need to be considered in terms of the costs and benefits arising from such activity.

60. The tax system currently provides concessions to improve the asymmetric tax treatment of profits and losses in cases where it is expected that the very nature of the desired investment activity will involve risk taking or incur a loss before returning a profit.

- Under the new R&D tax incentive, companies with an annual turnover of less than $20 million can claim a 45 per cent refundable tax offset in respect of their eligible R&D activities. While the incentive is directed at encouraging R&D activities that give rise to positive externalities, it is delivered through the refundable component of the R&D tax incentive that essentially provides an enhanced form of loss refundability.

- The incentive for designated infrastructure projects announced by the Government in the 2011-12 Budget proposes that tax losses attributed to a designated infrastructure project be uplifted and exempt from COT and SBT (although the loss is exempt from SBT, losses attributed to a designated infrastructure project can only reduce future assessable income from that same project). This targeted measure recognises that the current treatment of losses in the tax system discourages investment in infrastructure projects, being longer-life assets that are more risky.

- Allowing early-stage venture-capital limited partnerships to flow-through losses to partners improves loss utilisation as the beneficiaries can offset the losses against other income, rather than risk the losses being trapped in the investment vehicle.

61. To the extent that losses comprise deductions for interest expenses, improving the access to losses would be expected to add to the existing bias towards debt funding. The Working Group will examine the different tax treatment of debt and equity when exploring the potential longer term reforms for the business tax system.

2.3.2. The asymmetric tax treatment of profits and losses impacts on cash flow

62. As the Government does not share in the impact of any loss and instead businesses must bear the full impact of any loss in an income year, which can only be utilised if the tax loss is able to be carried forward to reduce future profits, the asymmetric treatment has a negative impact on a business’s cash flow.

63. This cash flow impact can detrimentally impact on a company’s future economic prospects, especially where the company requires short-term liquidity to survive. Not only does cash flow impact on business's ability to meet day-to-day liabilities, it also reduces the ability of a business to invest in R&D and staff training and development and other activities that help to increase the

10 OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (2011) p.26.

11 Australia’s Future Tax System Review, *Final Report to the Treasurer* (2009) p.174.

viability of the business in the long-term and add to productivity. Poor cash flow can not only impact on a business's ability to invest from its cash flows, but can also limit its access to commercial funding through debt and equity markets.

2.3.3. Current integrity measures may need to be revisited

64. The COT and SBT sharpen the effect of the tax system's asymmetric treatment of tax losses. The design of these rules may have the effect of 'locking' a company into suboptimal operations and structures in the hope of utilising their carried-forward losses sometime in the future. Companies may therefore have a financial incentive that may encourage further inefficient investment when a change in ownership structure or strategy is commercially or economically optimal.

65. Some of the integrity risks related to the possible creation of artificial tax losses, which form part of the rationale for the existence of the COT and SBT, are also less of a risk following the introduction of the income tax consolidation regime and the rules to address loss duplication in the early 2000s.

66. To the extent that concerns about creating artificial tax losses and any inappropriate transferring of tax losses still exists, there may be alternative measures to the COT and SBT which combat these concerns but are less likely to stand in the way of legitimate business decisions.

3. POSSIBLE APPROACHES TO REFORM

67. Australia's economy today is more dynamic and open to global forces than it was when the current rules around the tax treatment of losses were introduced. The impact of the current tax treatment of losses on business decision making arguably imposes higher costs on the economy.

68. The business tax system has also undergone significant change, including the introduction of the loss duplication rules to restrict the artificial creation of tax losses and the introduction of income tax consolidation. The changes to restrict the creation of artificial tax losses lead to the question of whether current integrity measures, specifically COT and SBT, remain necessary. To the extent that integrity concerns remain, it may be possible to develop alternative tests that are more adaptive to the current economic environment.

69. Against this background, the Working Group provides four possible reforms that could be pursued individually or as elements of a suite of reforms to improve the treatment of losses:

- **Element A** — remove the COT and SBT and introduce an alternative integrity test
- **Element B** — allow losses to be refunded
- **Element C** — introduce a time limited form of loss carry back
- **Element D** — apply an uplift factor to losses

70. Element A retains the fundamental features of the current tax treatment of losses. Element B is not proposed as a viable reform element, as it would substantially increase the risks to Government revenue and increase the potential integrity risks to the tax system. However, all reform elements are assessed against the benchmark of immediate loss refundability, which theoretically provides perfectly symmetrical treatment of profits and losses. Elements C and D represent a structural shift in the way that tax losses are treated.

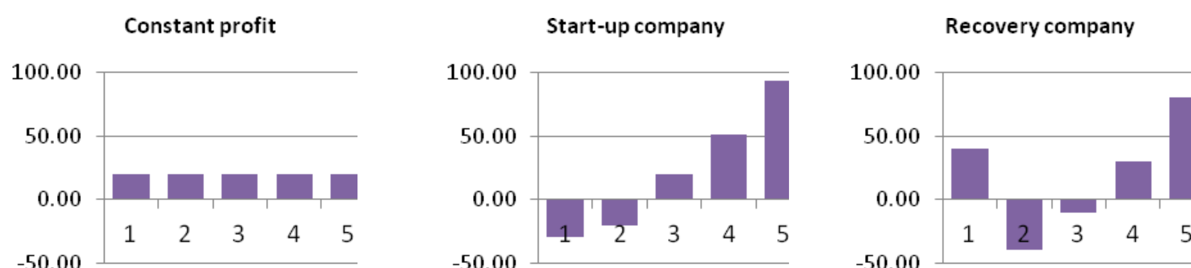
71. Reform elements are proposed to only apply to new tax losses. That is, tax losses incurred from a prospective income year onwards

Stylised benchmark scenarios

72. The potential impact of each reform element will be illustrated using three stylised companies considered over a five year period.

- A constant profit company — a representation of a consolidated group.
- A start-up company — makes a loss for the first two years then gradually becomes profitable.
- A recovery company — moves from profit to loss and back to profit again.

Chart 1: Nominal profit by company type



73. Table 3 sets out the benchmark scenario for each company — the company's profits before and after tax on both a nominal and net present value (NPV) basis and the company's effective tax rate (also presented on a nominal and NPV basis) assuming that any (and all) tax losses incurred can be carried forward and offset against future income. This benchmark will be used to illustrate the impact of each of the possible reforms.

74. The use of the NPV of before-tax profits and after-tax profits is to allow the annual impacts to be compared on the same base-level (Year 0). In all of the benchmark scenarios the NPV before-tax profit is equal ($87) and therefore the before-tax situation for each company is equal in base terms.

Table 3: Benchmark profits and effective tax rates

Company type	Year					Nominal			NPV		
	1	2	3	4	5	Profit before-tax	Profit after-tax	Effective tax rate	Profit before-tax	Profit after-tax	Effective tax rate
Constant profit	20	20	20	20	20	100	70.0	**30%**	87	60.6	**30.0%**
Start up	(30)	(20)	20	51	95	116	81.2	**30%**	87	59.2	**31.6%**
Recovery	40	(40)	(5)	32	80	107	74.9	**30%**	87	59.3	**31.4%**

* The NPV calculation uses a 5 per cent discount rate and a base year of Year 0. Numbers in the table have been rounded.

Amend the integrity rules

3.1. Element A — remove COT and SBT

75. Removing the COT and SBT would increase the potential for a company to use its carry forward tax losses to reduce its current year taxable income, regardless of whether it experiences a change in ownership or a change in the nature of business it conducts. This means that, for example, companies that seek new equity partners, restructure their ownership arrangements, embark on new commercial ventures and cease unviable or unprofitable components of their business, would not be denied access to past tax losses.

76. Where a company with carry forward tax losses experiences a substantial, or complete (that is, 100 per cent), change in ownership, the acquiring entity would not be restricted in using those tax losses to offset their taxable income. The utilisation of embedded tax losses in an acquire company would be an inevitable consequence of abolishing COT and SBT.

77. Any change to the COT and SBT would require consideration of the interaction of those rules with the bad debt rules.

3.1.1. Potential benefits

78. The removal of the COT and SBT would be broad in its application — theoretically benefiting all companies, regardless of their size or their profit or loss profile. In practice, it is likely to be most beneficial (relative to the status quo) for small businesses and those that are not part of a consolidated group as they may not have income from a range of activities to spread deductions across in the first instance. Consolidated groups will, however, also benefit as the COT and SBT rules still restrict the use of tax losses derived within the consolidated group from year to year.

79. In assessing the potential after-tax returns on a new investment, a business would be able to factor in the tax value of any potential tax losses associated with the investment. The tax loss will either be used to offset future income of the business or be factored into the sale price of the business. The impact of this increased potential ability to use tax losses may reduce some of the commercial bias against risky (or previously unprofitable) investments.

80. Removing COT and SBT goes some way to ameliorating the asymmetric tax treatment of profits and losses, by increasing the ability for tax losses to be used, even where the benefit of the tax loss may be utilised by a different economic owner from the economic owner that incurred the tax loss. This increased utilisation of tax losses could be seen as a form of de facto refundability over time[12], with the private sector rather than the Government providing the cash flow benefit to the company that incurred the tax loss, because the value of the tax loss would be expected to be effectively incorporated into the sale price of the business.

81. The Government would ultimately bear the cost through a reduction in future taxable income of the purchasing business claiming the loss deduction, but may also recover increased tax referable to any taxable profit derived by the vendor of the relevant business on the commercial value of the tax losses. Improved cash flow could also be used for further investment that may produce increased revenues for the Government, either in the form of increased income tax or increased capital gains tax, compared with the alternative of a business simply ceasing to exist and consequently ceasing to generate any taxable income at all in the future.

82. As such, removing COT and SBT will decrease the tax-induced bias towards less risky investments, with a positive impact on innovation and the responsiveness of businesses to change and commercially-driven acquisitive business behaviours.

3.1.2. Potential risks

83. Making it easier for companies to utilise tax losses relative to other jurisdictions could create international arbitrage opportunities. Attracting loss generating or utilisation activity into Australia on this basis would impose a substantial absolute reduction in Government revenue from the business tax base.

3.1.3. Who would be affected?

84. In the benchmark scenario, it is assumed that COT and SBT have no impact. Reversing this assumption so that all tax losses incurred by the start-up company and the recovery company become 'trapped' because they fail the COT and SBT is set out in Table 4. It demonstrates the impact that the COT and SBT can have on the effective tax rate faced by companies who make a tax loss. The outcomes for the constant profit company remain unchanged.

---

12 The extent to which this holds depends on the extent which the COT and SBT are replaced with alternative integrity measures.

Table 4: Impact of trapped losses

Company type	Nominal			NPV			Comparison to benchmark (Table 3)
	Profit before-tax	Profit after-tax	Effective tax rate	Profit before-tax	Profit after-tax	Effective tax rate	Change in effective tax rate
Constant profit	100	70.0	**30.0%**	87	60.6	**30.0%**	**No change**
Start up (trapped losses)	116	65.9	**43.0%**	87	51.7	**40.3%**	**Increased by 8.7% (NPV)**
Recovery (trapped losses)	107	61.4	**42.6%**	87	48.4	**44.1%**	**Increased by 12.7% (NPV)**

* Numbers in the table have been rounded.
* The company in constant profit has no change as it has not incurred losses in the benchmark scenario. If the removal of COT and SBT allow the constant profit company to use other losses, this would shield some of the company's profits from tax, thereby reducing the effective tax rate below 30 per cent.

3.1.4. Other issues

85. To the extent that a company would not have failed the COT and SBT, the removal of these tests arguably has no effect. However, companies incur costs in complying with the integrity tests. Removal of the tests would therefore decrease the costs associated with carrying on the business, potentially freeing up capital to be used more efficiently by the business. The COT and SBT also impact on business valuations resulting in negative fund raising outcomes on debt and equity bases for businesses with embedded tax losses.

3.2. Element A — alternative integrity test

86. Increasing loss utilisation by removing the integrity measures allows tax losses to be more easily accessed by businesses, which decreases the risk bias in decision making. However, improving tax loss utilisation can also undermine the integrity of the tax system if it allows businesses to derive benefits from artificial tax losses. An option to partially address this concern is to apply the integrity rules that currently apply to tax losses brought into a consolidated group.

3.2.1. Applying the available fraction rule more broadly

87. Where tax losses are transferred from a joining entity to the head company of a consolidated group, they are subject to the available fraction rule. The available fraction is calculated as:[13]

$$\frac{\text{Modified market value of the loss entity}}{\text{Adjusted market value of the consolidated group}}$$

88. An available fraction is applied to tax losses held by an entity that joins a consolidated group. Additional rules exist to prevent taxpayers from inappropriately manipulating the calculation.

89. The available fraction rule ensures that the tax losses are able to be used by the group at approximately the same effective rate that they would have been used had the entity remained a stand-alone taxpayer. This available fraction rule acts as an integrity measure to ensure that tax losses once brought within a consolidated group are not immediately accessed if they would not have been immediate used outside the consolidated group[14] and therefore reduces the risk associated with potential loss trading, including integrity risks to the tax base and increased risks to Government revenue.

13 Section 707-320 of the ITAA 1997

14 This depends on the adjusted market value of the consolidated group.

90. The available fraction rule provides a disincentive for companies to join a consolidated group only with the objective to allow the head company to get access to their tax losses.

91. This approach could be applied more broadly to provide a disincentive for acquiring loss companies with a purpose of accessing tax losses, rather than a broader commercial purpose. For example, wherever a company acquires 100 per cent of the shares in another company with accumulated tax losses (outside of the consolidation context) the acquiring company could be allowed to utilise those tax losses at a rate determined by the ratio of the market value of both entities at the time the acquisition occurred. This may increase compliance costs as separate loss amounts would be subject to different available fractions.

3.2.2. Applying a dominant purpose test

92. An alternative approach would be to disallow deductions for carry forward losses obtained through a transaction undertaken for the dominant purpose of obtaining the losses. Such a test would apply on a facts and circumstances basis.

93. A dominant purpose test may be onerous to administer, given that the Commissions of Taxation would be required in the process of an audit, or request for a private ruling, to look at the facts and circumstances surrounding the transaction undertaken to obtain the tax losses.

Structural changes to the treatment of losses

3.3. Element B — loss refundability

94. A purely symmetrical tax treatment of losses and profits would require tax losses to be refunded in the income year in which the tax loss occurs. Therefore, a company in taxable profit would pay 30 per cent of the taxable profit as company tax, and a pure symmetrical tax treatment would allow a company in tax loss to be refunded 30 per cent of the tax loss.

3.3.1. Potential benefits

95. Immediate refundability of a tax loss ensures that the value of the tax loss is immediately realised. Companies would face a lower effective tax rate on new investments that have a probability of producing a loss, as they have the ability to utilise their losses in the current income year rather than having that benefit deferred. Under immediate refundability, the effective tax rate on all new investment should not exceed 30 per cent.

96. Under immediate refundability all businesses making tax losses could receive increased cash flow when they most need it for business reasons.

97. Immediate refundability would also significantly simplify the tax system's treatment of losses as they would no longer be carried forward and no carry-forward integrity measures would be required.

3.3.2. Potential risks

98. Refundability has a timing impact and absolute impact on Government revenue. Even in the situation where all tax losses are eventually carried forward and utilised, immediate refundability would increase the absolute cost to Government revenue because tax losses carried forward lose their value over time. Immediate refundability would also cause greater volatility in Government revenue as the impacts of refunding amounts to those in a loss position would be more pronounced during a downturn in the economy.

99. Immediate tax loss refundability may also provide opportunities for exploitation, particularly if refunds were made on the basis of assessments that were later amended. The Commissioner of Taxation currently has four years in which to amend a business' tax assessment.[15] This time period is reduced to two years for simplified taxpayers.

3.3.3. Who would be affected?

100. Tax loss refundability would improve certainty about access to tax losses. As can be seen in Table 5, the NPV effective tax rate in all companies under immediate refundability is economically equal (30 per cent).

Table 5: Impact of loss refundability

Company type	Nominal			NPV			Comparison to benchmark (Table 3)
	Profit before-tax	Profit after-tax	Effective tax rate	Profit before-tax	Profit after-tax	Effective tax rate	Change in effective tax rate
Constant profit	100	70.0	**30%**	87	60.6	**30%**	**No change**
Start up	116	81.2	**30%**	87	60.6	**30%**	**Decreased by 1.6% (NPV)**
Recovery	107	74.9	**30%**	87	60.6	**30%**	**Decreased by 1.4% (NPV)**

*The NPV calculation uses a 5 per cent discount rate. Numbers in the table have been rounded.

101. While the potential benefits of immediate refundability would be significant, so would the potential costs. The Working Group also notes that no other jurisdiction offers immediate refundability of tax losses.

102. The Working Group does not propose immediate refundability as a viable option for the foreseeable future. Immediate refundability does, however, provide a benchmark against which to assess alternative options. These alternatives are assessed below.

3.4. Element C — time limited loss carry back

103. Loss carry back would allow companies to carry current year tax losses back to be offset against previous year's profits, resulting in a refund of tax previously paid. As such, loss carry back is limited to the taxes paid in previous income years. That is, the maximum refund under a one-year loss carry back would be the taxes paid in the previous income year.

104. Whilst in theory companies could be permitted to carry back a current year tax loss to any previous year, common practice internationally is to limit the carry back period. This also makes sense from an administrative perspective, given that the administrator has a specific time to audit returns and companies will need to open up past returns in order to apply their losses to previous years' profits. Factors that might influence the choice of carry back period are discussed below.

105. A company's capacity to carry back a current year loss would also be restricted to its franking account balance. The Australian tax system has a dividend imputation system, which means that the company tax system acts as an effective withholding system on personal income tax, whereby the company pays tax and distributes franking credits to individual shareholders, who then, depending on their marginal tax rate and tax status, either receive a refund of taxes paid at the company level or pay a top-up amount of tax.

15 There is an unlimited amendment period in cases of fraud.

106. Given the operation of the dividend imputation system, any application of a loss carry back would need to be designed so that the carry back is constrained to the available franking account balances of the company to avoid a reversal of franking credits that have already been distributed to shareholders.

107. Loss carry back is initially constrained by the amount of taxes paid in previous income years and then further constrained by the franking account balance. Given this, the dividend payout decisions of companies may be influenced by the introduction of loss carry back, as companies may decide to reduce the amount of franking credits distributed to shareholders in an attempt to increase their franking account balance and potentially manage future tax positions under loss carry back.

108. The Australia's Future Tax System Review recommended a one year carry back for company revenue losses, with the amount of any refund limited to a company's franking account balance.[16]

3.4.1. Potential benefits

109. Currently profitable companies could invest knowing that if they subsequently make a tax loss they may be able to realise the benefit of that loss immediately (subject to taxes paid and franking account balances). This may impact on the decision making process of those profitable companies, as there is an increased level of certainty in future after-tax returns.

110. A by-product of loss carry back is an improvement to the cash flow of businesses. This proposal would therefore be of benefit to those companies that are experiencing a loss of competitiveness due to the current structural changes in the economy.

111. It would also enhance the ability of the business tax system to act as an automatic stabiliser (in the same way that the personal tax and transfer system operates for individuals). The effectiveness of an automatic stabiliser will depend on the timing and magnitude of its impact and the timing and magnitude of the downturn.

3.4.2. Potential risks

112. Under loss carry back, company tax revenue would likely be both more variable and would deliver less revenue to the Government in an economic downturn.

113. There are also risks that the Commissioner of Taxation may have a tax assessment open at the same time a business wants to carry a loss back and amend their assessment. It may be appropriate to review the current limited amendment periods for those businesses choosing to carry back losses.

3.4.3. Other issues

114. This possible reform element assumes that loss carry back would be limited to a period of one to three years.

115. A carry back period of between one and three years would be consistent with international practice (see Appendix B). A number of factors may influence the choice of carry back period. A one year carry back period would limit the Government's exposure to refunds payable. However, it would mean loss carry back was of less use to companies that experience multiple loss years or volatility of tax profile over a number of years rather than moving regularly from profit to loss (and back again). A two or three year carry back period would provide greater opportunities for carry back to occur and a better 'smoothing' impact on the tax treatment of companies.

---

16 See Recommendation 31, Australia's Future Tax System Review, *Final Report to the Treasurer* (2009) p.176.

116. The period of loss carry back can also be amended to reflect current business needs. For example, after the global financial crisis, in an effort to stimulate business activity the United States and the United Kingdom both extended the allowable time period over which losses could be carried back.

117. In the first instance, the United States restricted the extended carry back to small businesses who were allowed to carry losses in 2008 back to offset income earned in up to five years prior, rather than two years. The extended carry back was intended to help struggling businesses, providing them with a quick infusion of cash.[17] Subsequent laws were then passed to extend the carry back period for other entities.

118. In the United Kingdom, the loss carry back period was temporarily extended from one year to three years for companies and unincorporated businesses for the 2008-09 income year.[18] Additional limitations were placed on the extended carry back, with the amount of loss that could be carried back to the earliest two years of the extended period being capped at £50,000 per year.

119. Alternatively, rather than being time limited, the amount of any loss capable of being carried back could be capped to only allowing a portion of the tax loss to be carried back. This would dampen the impact of loss carry back in partially ameliorating the tax system's bias against risk but would potentially make it easier for the Government to manage the fiscal impact of such a change.

3.4.4. Who would be affected?

120. Returning to our stylised companies, loss carry back would benefit the recovery company that has previously paid tax by reducing the effective tax rate faced by those businesses (see Table 6).

121. Introduction of loss carry back does not impact on those companies that have not paid tax in the years before a loss is incurred (start-up company) or if the losses cannot be carried back (if it is trapped by integrity rules), or because the company has a zero (or low) franking credit balance (meaning that they have distributed all franking credits to shareholders). A loss carry back would not impact on companies in constant profit.

Table 6: Impact of loss carry back

Company type	Nominal			NPV			Comparison to benchmark (Table 3)
	Profit before-tax	Profit after-tax	Effective tax rate	Profit before-tax	Profit after-tax	Effective tax rate	Change in effective tax rate
Constant profit	100	70	**30%**	87	60.6	**30.0%**	**No change**
Start up	116	81.2	**30%**	87	59.2	**31.6%**	**No change**
Recovery	107	74.9	**30%**	87	60.5	**30.1%**	**Decreased by 1.3% (NPV)**

*The NPV calculation uses a 5 per cent discount rate. Numbers in the table have been rounded.

3.5. Element D — applying an uplift factor

122. The current tax system allows tax losses to be carried forward and deducted against future income, but the real value of the tax loss carried forward erodes over time. An uplift factor could be

17 See the Internal Revenue Service website, *New Law Extends Net Operating Loss Carryback for Small Businesses; IRS To Ensure Refunds Paid Timely* <http://www.irs.gov/newsroom/article/0,,id=205329,00.html>

18 For companies the new rules apply for accounting periods ending between 24 November 2008 and 23 November 2009, while for unincorporated businesses the new rules apply for the tax year 2008-09.

applied to tax losses as they are carried forward. The long term (ten-year) Government bond rate is often used as a risk-free rate of return and may be appropriate as an uplift rate.

3.5.1. Potential benefits

123. An uplift factor applied to carry forward tax losses would decrease the effective tax rate on investments that have the potential to produce a loss if it is assumed that those entities will make a profit in the future and utilise the loss.

124. Applying an uplift factor would provide the greatest benefit to those companies undertaking projects with a long lead time between up-front capital costs and subsequent revenue. The Government has already announced its intention to uplift losses associated with designated infrastructure projects (and to exempt those losses from COT and SBT).[19] Applied on a whole of economy scale, this would also benefit start-up companies, other companies considering restructuring or innovating and other initially capital-intensive businesses.

125. The uplifting of tax losses in the absence of other reform options would not increase tax loss utilisation. However, it would increase the value of the tax loss that is utilised to reduce taxable income in the income year in which the tax loss is utilised and therefore impact on the ultimate amount of tax payable. In cases where the increased tax loss value is able to be utilised, it will increase cash flow for businesses in the income year of loss utilisation.

3.5.2. Potential risks

126. Growing the stock of tax losses by an uplift factor will reduce Government revenue relative to the current treatment, since taxpayers will have access to larger future deductions in respect of their accumulated tax losses. Given that the uplift alone will not increase loss utilisation, there is still a risk that tax losses may become 'trapped' if the company is never in a position to utilise the tax losses (that is, never has sufficient profits to utilise all losses (including because of a cessation of business), or fails any integrity test that may apply in order to use the loss amounts).

3.5.3. Who would be affected?

127. Applying an uplift factor to company tax losses would reduce the effective tax rate on investments that have a probability of producing a tax loss, provided the tax loss can be utilised at some stage. This therefore reduces the bias against risky investment, or businesses relying on early significant expenditure, in the cases where it is expected that the tax losses will be ultimately utilised. Reduction in the risk bias should encourage better commercial risk taking in the economy which may facilitate innovation of techniques or products produced by industries.

128. A tax loss uplift factor would benefit start-up companies and those in recovery, on the basis that those companies make it through the trough in their business cycle and can eventually use those losses against future profits (see Table 7 below). By contrast, the tax loss uplift factor would not benefit those companies in constant profit as they never derive a tax loss.

129. Of the three stylised companies, it is the start up company that would benefit most from tax loss uplift. The benefit derived by the recovery company would be limited as it starts generating a profit again quite soon after the tax losses are incurred and therefore not as much value is lost.

---

19 See Section 2 of this report

Table 7: Impact of loss uplift

Company type	Nominal			NPV			Comparison to benchmark (Table 3)
	Profit before-tax	Profit after-tax	Effective tax rate	Profit before-tax	Profit after-tax	Effective tax rate	Change in effective tax rate
Constant profit	100	70.0	**30.0%**	87	60.6	**30.0%**	No change
Start up	116	82.9	**28.2%**	87	60.9	**29.7%**	Decreased by 1.9% (NPV) Decreased by 1.8% (nominal)
Recovery	107	76.7	**28.3%**	87	60.8	**29.8%**	Decreased by 1.6% (NPV) Decreased by 1.7% (nominal)

*The NPV calculation uses a 5 per cent discount rate and a 5.75 per cent uplift rate. Numbers in the table have been rounded.

3.6. Possible combinations of elements

130. The loss reform elements could be implemented individually or in combination. For example, the COT and SBT could be removed and replaced with an alternative integrity test at the same time as two year loss carry back is introduced with an uplift factor applied to any losses carried forward.

131. The exact benefits derived by companies under the different combinations of the loss reform elements will be determined by a company's individual facts and circumstances. Broadly, removing COT and SBT will impact on all businesses, loss carry back impacts on previously profitable companies, while loss uplift helps start-up companies and those companies making investment involving long lead times until profits are made.

132. As outlined in the Working Group's terms of reference, the costs of any reform options will need to be offset by savings from business taxation measures and therefore be revenue neutral. Implementation of a combination of reform elements will have a greater cost than the implementation of any one of the elements in that combination and therefore will require greater savings from business taxation measures to ensure the reforms are revenue neutral.

133. Table 8 summarises the different combinations discussed below. All combinations assume that the removal of COT and SBT is accompanied by a new integrity provision.

3.6.1 Combination 1 — Remove COT and SBT & allow loss carry back (A and C)

134. Removing COT and SBT would allow a business to undertake a change in ownership and business activity and still be able to access their tax losses. Alternative integrity provisions would reduce the opportunities for any inappropriate 'loss trading' that may result following the removal of the COT and SBT. Alternative integrity provisions would also limit any international arbitrage opportunities in the treatment of losses, which could result in a flow of loss generation or inappropriate loss utilisation into the country at a substantial cost to revenue, without necessarily improving the climate for investment.[20]

135. Changing the integrity provisions to ensure that they do not restrict a business' ability to change and adapt in the changing environment because it comes at the cost of losing the access to their losses, will make it easier and more viable for businesses to change their ownership and business activity.

20 Australia's Future Tax System Review, *Final Report to the Treasurer* (2009) p.174.

136. Tax loss carry back would allow partial refundability, resulting in the refunds on taxes paid previously (where those taxes have been paid in the allowable carry back time period or within the franking account balance measures). This would improve the cash flow for previously profitable companies and reduces the effective tax rate they face overall, as businesses will receive some (limited) relief in the same year that they derive a tax loss, rather than having to carry the entire value of the tax loss forward.

3.6.2. Combination 2 — Remove COT and SBT & apply loss uplift (A and D)

137. The removal of COT and SBT would allow a business to undertake a change in ownership and change the business activity and still be able to access their tax losses against future income of the business. Alternative integrity provisions could limit the opportunities for any inappropriate loss trading and any international arbitrage opportunities due to the different tax treatment of losses.

138. The uplift factor applied to a carried forward tax loss ensures that the tax loss maintains its real value, which can significantly benefit investments that are characterised by upfront tax losses and long lead times before profits are derived. Applying an uplift factor to tax losses in itself will not improve tax loss utilisation, but, when coupled with the removal of COT and SBT, there would be an increased ability for an entity to realise the uplifted tax loss, even in cases where there is a change in ownership or business activity.

3.6.3. Combination 3 — Remove COT and SBT, allow loss carry back & apply loss uplift (A, C and D)

139. Building on Combination 1 and applying an uplift to any carry forward tax losses will mean that any tax losses not realised through loss carry back maintain their value.

140. The uplift factor applied to a carried forward tax loss ensures that the tax loss maintains its real value. This can significantly benefit investments that are characterised by upfront tax losses and long lead times before profits are derived. Applying an uplift factor to tax losses in itself will not improve tax loss utilisation, however when coupled with the removal of COT and SBT, there would be an increased ability for an entity to realise the uplifted tax loss, even in cases where there is a change in ownership or business activity.

Table 8: Possible combinations

<table>
<tr><th></th><th>Element C
Time limited loss carry back</th><th>Element D
Apply an uplift factor</th></tr>
<tr><td rowspan="2">Element A
Remove the COT and SBT and replace with an alternative integrity test</td><td>Replacing COT and SBT would improve the access to tax losses for all businesses. Being replaced with an alternative integrity test would restrict benefits arising from any inappropriate utilisation of tax losses.

Loss carry-back will benefit (by reducing the risk bias in decision making and improving cash flow) for companies in recovery and companies that are able to carry the tax loss back.</td><td>Replacing COT and SBT would improve the access to tax losses for all businesses. Being replaced with an alternative integrity test would restrict benefits arising from any inappropriate utilisation of tax losses.

The uplift factor benefits start-ups, recovery companies and companies with high initial expenditure that will eventually be able to utilise tax losses through profitable activities.</td></tr>
<tr><td colspan="2">A combination of these options would improve the access to tax losses for all businesses while restricting benefits arising from inappropriate utilisation of tax losses. Tax loss carry-back will benefit (reduce the risk bias in decision making and improve cash flow) for companies in recovery and able to carry the tax loss back and the uplift factor would benefit start-ups and recovery companies that will eventually be able to utilise tax losses.</td></tr>
</table>

3.7. Scope of tax losses to which the new rules would apply

141. Whether any new rules would apply to accumulated tax losses or only tax losses incurred after a specified date and whether they would apply equally to capital and revenue losses is a policy choice and the costs and benefits of the different potential applications would need to be examined.

3.7.1. New losses only

142. Application of any of the reform elements discussed in Section 3 could be limited to tax losses incurred from a specified income year onwards or potentially apply to all tax losses, both new and existing.

143. The Working Group considers, however, that any reforms to the tax treatment of losses should only apply prospectively, given that the primary aim of the reforms to the tax treatment of losses is to improve productivity by improving decision making in the economy and delivering tax relief to struggling businesses (without distorting existing business decisions based on current tax law). That is, reforms would only apply to new losses, as the reforms are targeted at removing distortions on future decision making. Existing tax losses represent economic activity that has already occurred. As such, enhanced treatment of such tax losses does nothing to improve business decision making. Changing the treatment of losses accumulated in the past would therefore have little impact on future productivity. Given that there is currently $170 billion worth of accumulated tax losses in the tax system, any retrospective application of the reforms would also come at a substantial cost to Government revenue and represent a substantial cost for the Government.

144. The Working Group, therefore, does not propose to consider options that would alter the taxation treatment of accumulated losses.

3.7.2 Size of business

145. There may be merit in restricting the availability of loss carry back arrangements to businesses of a certain size. It could be expected that larger companies with diversified operations would have an increased ability to utilise losses as profits from certain operations within their business could be offset by losses resulting from other operations in the business structure. Capping the amount of losses that could be carried back, or restricting the carry back to businesses within a specified turnover threshold, may be a way of targeting the measure to small and medium sized businesses.

3.7.3. Revenue and/or capital losses

146. Currently, revenue losses can be applied against revenue gains and capital gains, while capital losses are quarantined and can only be applied against capital gains. In theory, any of the reform elements could be applied to revenue losses only or to both revenue and capital losses but retaining the existing restriction that they can only be applied against gains of the same type.

4. Other reform elements — black hole provisions

147. The black hole provisions are 'provisions of last resort' under which some capital expenses not depreciable or deductible under any other provisions are deductible for tax purposes. Generally, the black hole provisions apply to expenses incurred in starting up, changing or shutting down a business. As such, they are especially relevant in an economy undergoing structural change.

4.1. The black hole provisions

148. In 2001 the black hole provisions were introduced into the tax law (section 40-880 of the ITAA 1997) to allow a five-year write off for specific types of business-related capital expenditure which had not previously received relief in the tax system.

149. These provisions were replaced by new provisions which apply to business-related capital expenditure incurred on or after 1 July 2005 and continue to allow write-off over five years.

4.2. Relevance to business decision making

150. The black hole provisions provide taxation relief for the costs incurred by businesses considering changes to the way they do business; for example, firms undergoing structural adjustment processes may incur expenses in order to explore new business opportunities, put in place new business strategies or shutdown parts of the business.

151. The requirement in the current provisions that expenditures can be written off over five years can impose cash flow constraints on businesses seeking to react in the face of structural change.

4.3. Possible approaches to reforming the black hole provisions

152. An option to improve the way the tax system deals with expenditure incurred in restructuring a business is to allow expenses under the black hole provisions to be written off over a shorter time period, say one to three years instead of five years. Allowing expenditure incurred in changing, starting or closing a business to be deductible over the shorter time period increases the ability for business to access those deductions.

153. An alternative option would be to only reduce the write off period for expenditure related to a shut down. An immediate write-off may be more appropriate, given the reduced likelihood that the business will have sufficient future income for the deductions to offset. This would provide cash flow that would be reinvested in alternative, more profitable, ventures.

4.3.1. Potential benefits

154. Providing more timely access to the deduction will improve cash flow for businesses that can utilise the deduction.

155. Allowing a shorter write-off period would benefit all taxpayers undergoing structural adjustment that can utilise the deductions, without prejudging the end point or direction of that process. A shorter write-off period reduces the tax burden for the specific and limited range of investments undertaken during structural change within an economy.

156. More timely access to deductions would also be supported by enhanced treatment of losses.

4.3.2. Potential risks

157. A shorter write-off period will have a timing impact on Government revenues. To the extent that all deductions would be eventually used under the current rules, there is no impact on the overall quantum of deductions available.

4.3.3. Who would be affected?

158. A shorter write-off rate would most benefit all taxpayers undertaking eligible expenditure.

5. Conclusion

159. In an economy undergoing structural change Australian businesses need to be flexible and responsive to new challenges and opportunities. To the extent that the business tax system is putting up barriers to optimal business activity then it is worth considering how those barriers can be removed or reduced. The tax treatment of losses is one area where the tax system is imposing a distortion on business decision making. The asymmetric tax treatment of profits and losses, sharpened by current integrity measures, creates a bias against investments that involve a higher level of risk or a higher level of initial expenditure in a business venture. There are a range of ways in which the asymmetric tax treatment of profits and losses and current integrity measures could be reformed.

160. While reducing the impact of the tax system on business decision making is the Working Group's primary goal, the integrity of the tax system and the cost to the Budget of implementing any changes are also important considerations. The Working Group has also been tasked with advising the Government on longer term directions for business tax reform. While reforms to the tax treatment of losses may be beneficial, there may be other broader changes to the framework of taxing Australian business income with the potential to deliver greater benefits.

161. The Working Group's interim conclusion is that the tax treatment of losses merits closer consideration. Whether specific reforms should be pursued will be the subject of the Working Group's final report to the Treasurer on the tax treatment of losses, due in March 2012.

162. As required by its terms of reference, the Working Group intends to conduct consultation on the ideas set out in this interim report to inform the development of its final report. The Working Group will be particularly interested in the views of businesses themselves on the value they would place on reforms to the treatment of losses.

163. To the extent that any specific reforms are recommended, the Working Group will identify possible sources of offsetting savings.

APPENDIX A

BUSINESS TAX WORKING GROUP — MEMBERSHIP AND TERMS OF REFERENCE

Membership

Chris Jordan (Chair)
Chairman
Board of Taxation

Jennifer Westacott
Chief Executive
Business Council of Australia

Jeff Lawrence
Secretary
Australian Council of Trade Unions

Rob McLeod
CEO
Ernst & Young

Teresa Dyson
Chair, Taxation Committee, Business Law Section
Law Council of Australia

Peter Burn
Director of Public Policy
Australian Industry Group

Frank Drenth
Executive Director
Corporate Tax Association of Australia

John Freebairn
Professor of Economics
University of Melbourne

Rob Heferen
Executive Director, Revenue Group
The Treasury

Terms of reference

Objectives

1. The Working Group will make recommendations on how the Australian business tax system can be improved to make the most of the challenges and opportunities arising from transformations in the broader economic environment, including the patchwork economy.

2. The revenue neutral reforms to the business tax system will aim to increase productivity, while delivering tax relief to struggling businesses.

Scope

3. The Working Group will focus on reform options that relieve the taxation of new investment:

   3.1. in the near term, by reforming the tax treatment of business losses; and

   3.2. in the longer term, by reducing the corporate tax rate further or moving to a business expenditure tax system, particularly an allowance for corporate equity.

4. For its final reports, the Working Group will provide specific analysis of these business tax reform options, including:

   4.1. description of how these reforms options operate overseas and evidence on their effectiveness;

   4.2. potential priorities for reform, including transitional paths;

   4.3. worked examples of how these options would affect business taxpayers, including their financial and tax accounts;

   4.4. revenue integrity provisions, such as measures necessary to limit: the inappropriate claiming of tax losses; the equity allowance to new equity; and small and closely held businesses converting labour into business income;

   4.5. how the reform options integrate with the rest of the tax system now and in the future;

   4.6. impacts on national income and macroeconomic risks; and

   4.7. costings.

5. The working group will also identify a range of off-setting budget savings from existing Commonwealth business taxation (or spending) measures. Changes to the GST should not be considered.

   5.1. The savings to be generated by the particular options will be costed by the Treasury in accordance with the budget rules.

6. In developing its recommendations, the Working Group should have regard to the report of the *Australia's Future Tax System Review* and relevant international experience and expertise.

Timing

7. The Working Group is required to provide the Treasurer with:

   7.1. an initial report on the proposed directions for improving the tax treatment of losses and offsetting savings in mid-November 2011;

   7.2. a final report on the treatment of losses and the offsetting savings in March 2012; and

   7.3. a further report on longer-term business tax reform options and offsetting savings by the end of 2012.

Consultation

8. For its final reports, the Working Group should consult widely with industry and the broader community.

9. The Working Group may establish technical sub-groups to consider specific issues or seek input from other sources of expert advice.

Support

10. The Working Group will be supported by a Secretariat within Treasury.

APPENDIX B

TAX TREATMENT OF LOSSES BY COUNTRY

Country	Loss carry-back	Loss carry-forward	Restrictions	Exceptions	Rulings
Australia	No	Indefinite	Change of ownership and activity	Ownership tracing concessions apply to widely held companies	Yes
Austria	No	Indefinite[21]	Change of ownership and activity	Other (non-tax) considerations	No
Canada	3 years	20 years	Change of ownership and activity	Acquisition of corporations business activities[22]	No
Denmark	No	Indefinite	Change of ownership and other criteria[23]	Internal reorganisations	No
France[24]	3 years	Indefinite	Change of activity	No	Yes
Germany[25]	1 year	Indefinite	Change of ownership	Other (non-tax) considerations	No
Ireland	1 year[26]	Indefinite	Change of ownership and activity	Internal reorganisations	No
Italy	No	5 years[27]	Change of ownership and activity, mergers	Other (non-tax) considerations	Yes, in some cases
Mexico	No	10 years	Change of ownership and activity,[28] mergers[29]	Inheritance, donation, internal reorganisation, merger and split off that are not considered alienations for tax purposes[30]	No

21 A loss carry forward can only affect 75 per cent of income

22 Losses of a corporation generally may be carried forward and back as permitted by the Act. However, to restrict abuses, 'stop loss rules' were introduced to prohibit the transfer of losses by a corporation in certain circumstances. These rules generally apply in circumstances where there is a change of ownership and also in the acquired corporation's business activities.

23 These rules do not apply to financial enterprises, including banks.

24 France has recently reduced their carry-back period to one-year and capped the carry-back amount to €1 million. The changes to the France's carry back rules were enacted after the table was published in OECD *Corporate Loss Utilisation through Aggressive Tax Planning* (2011).

25 Monetary restrictions apply to the carry-back and to the carry-forward of losses.

26 If a trade is permanently discontinued the loss may be carried-back against profits of the same trade for the previous three years.

27 Losses which occur in the first three years from the beginning of the business activity can be carried forward indefinitely.

28 After a change of control and of ownership activity, a loss carry-forward can only offset profits from the same type of activity that generated the losses if the sum of the receipts derived during the last three years is less than the accumulated losses of the company.

29 Where a merger is carried out, only the merging company can carry forward the losses it has at that moment, and only for purposes of using them against profits derived from the same trade that originated the losses.

30 These only apply in the case of change of ownership and activity not to the case of mergers.

Country	Loss carry-back	Loss carry-forward	Restrictions	Exceptions	Rulings
Netherlands	1 year[31]	9 years	Change of ownership and activity[32]	Lack of tax avoidance motive	Yes
New Zealand	No	Indefinite	Change of ownership	Ownership tracing concessions internal reorganisations[33]	No
Norway[34]	No[35]	Indefinite	Change of ownership and other criteria	Lack of tax avoidance motive	Yes
Spain	No	15 years[36]	Change of ownership[37]	Internal reorganisations	No
Sweden	No	Indefinite	Change of ownership[38]	Internal reorganisations	Yes in some cases
Switzerland	No[39]	7 years	Change of ownership and restart of activity	Financial Restructurings	No
United Kingdom	1 year[40]	Indefinite (against profits of the same trade)	Change of ownership and activity	Internal reorganisations	No
United States	2 years[41]	20 years	Change of ownership	No	No

Source: OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (2011) p.32. (Data provided by participating countries).

31 Optional three year loss carry-back for losses from 2009, 2010 and 2011, for remaining losses a loss carry-forward of six years (as opposed to nine years) is allowed. The loss to be carried back is maximised at €10 million per year.

32 Additional restrictions are applicable in the case of holding and group financing companies.

33 In New Zealand losses can be carried forward after an internal group restructuring if continuity and commonality requirements are met.

34 Special rules apply to the petroleum sector: carry forward of losses with interest; tax value of losses refundable on cessation of activity; tax value of losses due to exploration refundable annually.

35 In case of liquidation a two-year loss carry-back is allowed. In addition, a temporary two-year loss carry-back has been introduced for losses from 2008 and 2009.

36 For newly established companies, the 15 year carry-forward period commences as from the first tax year in which profits are made. The amount and origin of tax losses needs to be documented by the taxpayer, who bears the burden of proof, through tax returns, self assessments, accounting records and other documentary support.

37 The amount of losses available for carry-forward is reduced by the difference between the parent company's basis in the shares and the selling price.

38 After an acquisition of control of a company, the loss carry-forward is deductable only up to 200 per cent of the acquisition price and it is not possible to use the loss carry-forward of the acquired company through group contributions during the first five years after the change of ownership.

39 One canton (Thurgau) allows a one-year loss carry-back for local taxes (§ 83 StG Thurgau).

40 If a trade is permanently discontinued certain losses may be c/b against profits of the same trade for the previous three years.

41 Generally two years but up to five years for 2008-2009 losses.