

21 April 2016



Division Head
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Company Tax Losses - Similar Business Test

We are pleased to provide a submission in relation to the above proposed changes to the company loss rules.

Broadly speaking, we are pleased the government has recognised the need to relax the loss rules for businesses run in a company structure. The new test recognises that practically in order to turn a loss making business around a company may need to both:

- Obtain additional funding; and
- Make changes to operations

Background

Currently, companies in order to deduct prior year losses against future taxable income must pass one of two tests. These tests are the continuity of ownership test and the same business test.

Traditionally, loss making companies may have raised new funding by issuing equity interests to third parties. These interests may have had rights to voting and/or dividends in a company attached to them. This corporate action thus could potentially lead to the continuity of ownership test being failed. This test is broadly failed where 50% or more of these interests were issued to entities that were not associates of the initial subscribers of the shares.

In order for the business to start making profits after this injection of cash, changes to operations would naturally follow. Due to the strict nature of the same business test, these changes would all too often lead to the losses incurred up to that point being lost to what is now a new business.

Practically and from a commercial perspective, when a business is making losses, in many cases, changes to the business are required to make the business profitable going forward. This can lead to a legally different business arising that would mean the current same business test is failed.

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This new business may be similar in that it operates within the same industry and has activities that are broadly the same. The purpose of this new test pursuant to the explanatory memorandum is to establish whether the *identity* of the business has changed. This is a formidable task and in our mind should not be the relevant policy objective.

Our recommendation

Identity and Source

We note that in determining whether a similar business is being run a number of key matters must be considered. These matters are listed in the proposed subsection 165-211(2) *Income Tax Assessment Act 1997* (Cth) as follows:

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

Our recommendation is that the source of assessable income in a high proportion of businesses would necessarily change as part of the process of making a formerly loss making business profitable.

We question whether this factor goes to the *identity* of the business. The majority of businesses view a subset of the public as potential sources of their assessable income. While they may have established sources of assessable income as a loss making business this may be precisely what needs to change to turn a business around.

Primary Production and Horses

A number of horse racing and breeding businesses due to the nature of the risks involved in this industry incur substantial losses at various points in time. This area and others primary producers due to unique challenges and circumstances should be considered when finalising these provisions.

The request is that a safe harbour rule that protects companies in primary production industries be implemented. For instance, businesses of primary production with losses under \$500,000 could be 'deemed' a similar business provided the new business is also in primary production. The integrity rules accompanying these provisions should also be considered with reference to these groups.

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Regards,

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