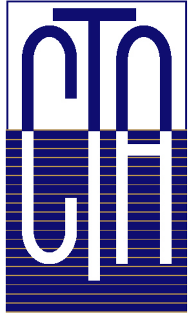


# Response to July 2012 Discussion Paper

# Improving Access to Company Losses

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## 8 August 2012

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**Discussion Paper – Improving access to company losses**

The Corporate Tax Association (CTA) is pleased to provide comments on the above discussion paper. Our comments reflect the discussions held at the consultation meeting on 31 July, which provided a useful opportunity to explore some of the issues raised in the Discussion Paper. Please accept our apologies for lodging the submission slightly after the due date.

While the proposed loss carry-back measures are not regarded by large companies as likely to have a significant impact on their investment decisions, we do recognise they have the potential to be of some benefit to some smaller companies that are experiencing temporary financial difficulties.

*Tax Offset*

As noted in the Business Tax Working Group's Final Report on the Tax Treatment of Losses, the use of a tax offset in the loss year may be a more effective delivery mechanism than amending the earlier target year.

On the question of what the relevant rate should be, we consider it should be the rate that applies in the utilisation year rather than the target year. This would place loss carry-backs on the same footing as losses that are carried forward, where any losses allowed as deductions in the income year benefit at the company income tax rate that applies in the income year rather than the loss year.

*Flexibility*

Any mechanical rules developed should not stand in the way of taxpayers carrying back losses to a target year where circumstances change, say as a result of ATO audit activity. Where the income in what would otherwise be a target year is offset against losses brought forward from a loss year preceding the target year, and the amount of that loss is reduced or disallowed, then the taxpayer should be able to make a consequential election to utilise up to $1 million in one or two post 2012 loss years. The rules around the timing of elections that apply the loss carry-back rules should therefore be flexible.

*Lodgements up to date*

We agree that lodgement of the company's prior year returns needs to be up to date where an exemption from the requirement to lodge has not been granted.

*Integrity Measures*

We are not convinced that any specific integrity measures are warranted around loss carry-backs. As discussed at last week's consultation meeting, the maximum revenue at risk for any one taxpayer is capped at $600,000 at current rates, whereas losses that can be carried forward are uncapped.

Further, the BTWG's Report on Losses highlighted a number of serious draw-backs around the current COT/SBT regime, which may be constraining businesses experiencing financial difficulties from striking out in different directions and being innovative just when they need to be. While the BTWG fell short of recommending a complete solution, the analysis in the report suggests the sorts of approaches that could be considered – e.g. a "substantially the same business" test, or a simple drip-feed over time. Rather than foisting all the problems of the COT/SBT regime on loss carry-backs (which represents a much smaller systemic risk), it is regrettable that Treasury has not taken this opportunity improve the existing regime – it shouldn't be that difficult.

Some of the work done by the ICAA in the lead-up to last week's consultation meeting suggests that realistically, the most likely (and possibly the only) scenario that might be of concern is where a start-up company that expects to encounter early losses acquires a dormant company that has franking credits.

It is submitted that the risk of Part IVA being applied to such an arrangement should deter all but the most adventurous (or foolhardy) from entering into such a transaction for the sake of at most two $300,000 tax offsets. By the time transaction costs are accounted for, including due diligence and advice, there would be little change from $600,000 – and that is before factoring in the tax risk.

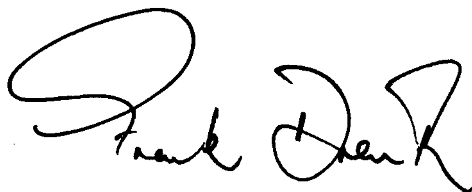
Even with a dominant purpose threshold, it would be difficult for a taxpayer to demonstrate what legitimate business purpose there was in acquiring an unrelated dormant entity that bears no relation to the activities of the start-up business. Part IVA would need to be amended to bring tax offsets within the scope of the definition of “tax benefit”, which should be happening already as a result of Treasury’s broader review of Part IVA that preceded the separate (and in our view ill considered) announcement to ‘fix’ the counterfactual ‘problem’.

We also note (page 12) that consolidated groups will not be able to carry back losses to a target year for a joining entity. We support such a rule, which would exclude most transactions that take place at the larger listed end of the spectrum

The CTA recognises that applying the COT/SBT regime may be seen as creating less risk from Treasury’s perspective. If there are no specific anti-avoidance rules and something were to go wrong, someone could be blamed. Sometimes it may well be better to be safe than sorry, but this is not one of those times. In the CTA’s submission a sensible and balanced assessment of where the risks lie should lead to the conclusion that if we simply rely on Part IVA it is highly unlikely those provisions would ever need to be applied.

We would be happy to discuss these matters further if you wish.

Yours sincerely,



(Frank Drenth)

Executive Director

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