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The General Manager
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The Treasury
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By email: LossCarryBack@treasury.gov.au

Submission on discussion paper “Improving access to company losses”

The Institute of Public Accountants (IPA) is one of the three professional accounting bodies in Australia, representing over 22,000 accountants, business advisers, academics and students throughout Australia and internationally. The IPA prides itself in not only representing the interests of accountants, but also small businesses and their advisors.

The IPA welcomes the opportunity to provide a submission on the abovementioned discussion paper. This submission is based on the views of IPA members and of the IPA Faculty of Tax and the IPA.

On 6 May 2012, the Government announced its intention to introduce a company loss carry-back initiative. The Government has acknowledged that such a measure will help businesses facing pressures in our patchwork economy, reduce disincentives to sensible risk taking and encourage investment and growth. IPA has long advocated in its pre-budget submissions for such a measure and we are therefore very supportive for a loss carry back regime to be introduced. Current tax rules that govern tax loss treatment hinder the ability of businesses to adapt and change which impacts on productivity and employment. Risk taking, investment and innovation are discouraged under the present loss treatment rules and changes are long overdue especially considering that many OECD countries have already adopted carry back rules.

The policy intent of this new initiative is to allow businesses to carry back their losses to offset past profits and get a refund of tax previously paid on that profit. The ability of companies to carry back losses will enable businesses to gain quicker access to their losses when they most need them and assist the continual survival of viable companies.

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Current rules only allow loss utilization in the future when companies are operating profitably and not whilst they may be under financial stress. We are supportive of any measure that brings forward relief to struggling companies. The ability to claim a refundable tax offset will improve the cash flow position of loss companies by allowing them to realize the value of losses earlier rather than later.

This new initiative addresses the main restriction with the current rules in that companies can bring forward the tax benefit associated with losses and not have to wait for the company to return to a tax profit position. In addition it improves utilization of losses as companies risk never being able to use them in future years due to failing continuity of ownership test (COT) or same business test (SBT). The COT and SBT are current integrity measures which can restrict utilization of losses in future years which can result in a zero tax benefit from past losses.

Whilst this new measure will not help companies who have already incurred losses in the 2012 or earlier income years, it is a welcome change to the current tax loss treatment and will help struggling companies in future years. Although the proposed initiative applies to all companies, it will be potentially more beneficial to smaller entities, as the amount of loss carry back is capped at \$1,000,000 of allowable tax losses or a maximum potential refund of \$300,000.

In relation to issues raised in the discussion paper around design features of the proposed loss carry back provisions, we provide the following feedback.

Delivery Mechanism

The policy intent behind the changes is to assist viable companies continue operations. Whilst amending previous year's return would have been the most expedient way to return previously paid taxes, we acknowledge the administrative difficulties going down this route and accordingly support the proposal to administer the loss carry back through the use of a refundable tax offset in the claim year.

Integrity Rules

Given that there will be a \$1 million quantitative cap, the maximum potential refund in any year will be \$300,000 based on a 30% tax rate. Given the policy intent is to help struggling companies deal with challenging economic conditions, it may be argued that no integrity rules other than limiting the refund to available franking account balance are required for companies to be eligible for loss carry back. By limiting any refund to past taxes paid ensures that access to the refundable tax offset is only available where franking credits have not been distributed to shareholders. Unlike carry forward losses, carry back losses are subject to maximum upper limits being lower of franking account balance or \$300,000. Part IVA could also be strengthened by extending it to include tax offsets that arise from a carry back of losses to capture instances where the dominant purpose is manipulation of the loss carry back rules to obtain a tax benefit.

If there are concerns that the proposed loss carry back will be subject to abuse (i.e. loss trafficking of companies with both franking credit balances and prior year tax payments) and further integrity rules are deemed warranted, then for simplicity and consistency the rules governing carried forward losses should be replicated for carry back losses.

Standalone integrity rules for loss carry back would introduce more compliance and administration cost. A Modified version of the existing rules would appear more appropriate.

Under existing rules, a company's ability to utilise carry-forward losses depends on whether it satisfies the continuity of ownership test or, failing that, the same business test. In general, the continuity of ownership test 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. 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 utilisation year).

The same business test is generally satisfied if the company is carrying on the same business in the loss utilisation year that it carried on immediately before the time it failed the continuity of ownership test.

The above tests would need to be modified so that the test period runs from the profit year to the claim year to enable existing tests that apply to carried forward losses to be replicated for carry back losses.

These tests are however governed by complex sections of income tax laws. Both the Henry Review (Australia's Future Tax System) and Business Tax Working Group have highlighted the need to simplify and provide more certainty to these rules. If these integrity measures were subsequently reviewed to give greater weight to simplicity and certainty then any such amendments to simplify these rules will apply equally to carry back losses and carried forward losses.

As stated earlier, the proposed loss carry back will not help companies who have carried forward losses incurred in 2012 or earlier years. The proposed loss carry back changes are intended to give mostly small businesses who have limited capacity to weather challenging conditions better access to more timely tax loss relief than would be the case under present rules. As companies are not the preferred entity of choice for small business operators, extending the principles of loss carry back to other entity types whilst problematic should also be considered if the primary purpose is to assist all small business incurring losses.

The IPA welcomes the opportunity to discuss further any of the matters we have put forward in our submission. Please address all further enquires to myself (tony.greco@publicaccountants.org.au or 0419 369 038).

Yours sincerely

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