[Insert DD month YYYY]

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| --- |
|  |

[Insert client name]

[Insert client position]

[Insert company name]

[Insert company address]

[Suburb state postcode]

Dear [insert client name],

**Re: Recoupment of company tax losses**

We note that at 30 June 2024, [insert company name] has carried forward revenue losses of $[insert amount] and capital losses of $[insert amount]. Further, [insert company name] is expecting to incur a revenue loss in the year ended 30 June 2025. [delete if not applicable]

**Executive Summary**

For a company to carry forward and subsequently utilise revenue and capital losses, the company generally needs to satisfy at least one of two tests in the year ending 30 June 2024. These are:

1. The continuity of ownership test (**COT**).
2. The business continuity test (**BCT**), which will be satisfied if the company passes either the:
	1. the same business test (**SBT**), or
	2. the similar business test.[[1]](#footnote-2)

Each of these tests are discussed below.

**Carry forward and utilisation of losses**

**COT**

Under the COT (contained in Division 165 of the *Income Tax Assessment Act* 1997(**ITAA 1997**)), shares carrying more than 50% of all dividend, voting and capital rights must essentially be beneficially owned by the same individuals or notional persons at all times during the ‘ownership test period’.[[2]](#footnote-3) The ownership test period starts at the beginning of the loss year and ends at the end of the year of recoupment. Further, the majority underlying ownership must be satisfied in relation to the same shares, unless the ‘same share same interest’ exemption in section 165-12(7) applies.

The tracing of such beneficial ownership can be done under a primary test where shares are beneficially owned directly by the individual shareholders in a company, or under an alternative test where it is reasonable to assume that shares in a company are beneficially owned by individuals through an interposed company at any time during the ownership test period.

For companies with discretionary trusts as shareholders, a single notional entity will be taken to beneficially own the shares held by the discretionary trust, provided a family trust election (**FTE**) has been made. If an FTE has not been made, the shares owned by the discretionary trust cannot be taken into account in determining if COT has been satisfied unless the discretionary trust satisfies the alternative tests in Division 165-F of the ITAA 1997.

In addition, certain concessional COT tracing tests are available to widely held and/or listed companies under Division 166 of the ITAA 1997.

**BCT**

If a company fails to satisfy the COT, it may still be allowed a deduction for prior year income tax and capital losses if it satisfies the BCT at the time of recoupment. The BCT will be satisfied if the company passes either of the following tests:

* the SBT or
* the similar business test.

Importantly, the similar business test can only apply to losses that are incurred after 1 July 2015, while the SBT can apply to all income tax and capital losses.

The BCT must be satisfied throughout the ‘business continuity test period’ which:

* ends at the end of the income year in which the loss is recouped and
* begins at the test time.

The test time commences on the date on which the COT test is failed following a change in 50% or more of the underlying beneficial ownership of shares in the company. However, for some companies, it may not be possible to show that COT was satisfied at any point in time, in which case the test time will be:

* start of the loss year if the company is in existence throughout the entire loss year or
* end of the loss year if the company comes into existence during the loss year.

**Same business test**

For a company to pass the SBT and recoup a loss it must satisfy all the following conditions throughout the BCT test period:

* the company must have carried on the same business at all times throughout the business continuity test period that it carried on immediately before the test time
* the company must have only derived assessable income from business of a kind during the business continuity test period that it carried on before the change in the beneficial ownership or control, and
* the company must have only derived assessable income from transactions of a kind that it had entered into in the course of its business operations before the change the beneficial of ownership or control.

Where the company will not able to satisfy COT (for example, where the company is owned by a discretionary trust that has not made a family trust election), the above test will need to be satisfied from the earlier of:

* end of the first year the company comes into existence or
* start of an income year where the company has made a loss (excluding the first income year).

Further details on the Commissioner’s views on the practical application of the SBT is in Taxation Ruling TR 1999/9.

The ruling provides that a company may contract or expand its activities without necessarily ceasing to carry on the same business. Accordingly, a company’s adoption of new compatible operations or its discarding of other operations will not necessarily cause it to fail the SBT provided the business retains its identity. However, where there is a change in the essential character of the business the SBT will be failed. For example, where there is a sudden and dramatic change resulting in the acquisition or loss of activities on a considerable scale.

Anti-avoidance measures also apply to prevent companies entering into arrangements before a change in the beneficial ownership or control that are specifically implemented to ensure that the SBT will be met. Such arrangements include carrying on a business not previously carried on or entering into a transaction of a kind not previously entered into prior to the COT test being breached, which were undertaken for the purpose of complying with the SBT from the date on which there was a change in majority underlying beneficial ownership.

**The similar business test**

Where a company does not satisfy either the COT or the SBT it may nonetheless be able to satisfy the similar business test.

The similar business test applies to tax losses and net capital losses incurred for income years beginning on or after 1 July 2015.

The similar business test broadly operates in a similar manner to the SBT but removes the negative limbs which causes the SBT to be failed if the taxpayer derives assessable income from a new kind of business or transaction.

A company will satisfy the similar business test (contained in section 165-211 of the ITAA 1997) if it carries on a similar business at all times in the year in which the loss is recouped to that carried on immediately before the test time.

In working out whether a business carried on immediately before the test time (i.e. the former business) is ‘similar’ to the business carried on throughout the income year in which the company wants to recoup the loss (i.e. the current business), the Commissioner provides his views in Law Companion Ruling LCR 2019/1. Relevantly, the Commissioner states that it will be necessary to consider the following factors:

* the extent to which the assets (including goodwill) that are used in the current business to generate assessable income were also used in the former business to generate assessable income
* the extent to which the activities and operations for which the current business generates assessable income were also the activities and operations from which the former business generated assessable income
* the identity of the current business and the identity of the former business, and
* the extent to which any changes to the former business resulted from the development or commercialisation of assets, products, processes, services or marketing or organisational methods of the former business.

As such, the similar business test requires that the overall business in the year in which the loss is recouped must be sufficiently similar to the business carried on before the test time. It may be difficult to satisfy the similar business test if substantial new business activities and transactions did not evolve from, and complement, the business carried on before the test time. In contrast, if a company develops a new product or function from the business activities already carried on, and this development opens up a new business opportunity or allows it to fill an existing gap in the market, the company is likely to satisfy the similar business test.

Like the SBT there are integrity measures to prevent companies making changes to their business prior to the change in ownership or control the company which are only undertaken so the company can satisfy the similar business test after the change in ownership or control.

**Other considerations**

The public officer of [insert company name] should be satisfied that the COT is satisfied, or failing that, the SBT or similar business test is satisfied, in order to carry forward and recoup the prior year revenue and capital losses.

We note also that where a company fails the COT and the BCT during a year, special rules in Subdivision 165-B of the ITAA 1997will apply to determine the taxable income and tax loss for the income year.

You should note that capital losses may only be offset against future capital gains. In contrast, revenue losses may be applied against both revenue profits and capital gains.

We recommend that COT testing or SBT functional analysis be conducted to support the position taken in the tax return with respect to tax losses.

To arrange a meeting to further discuss the loss recoupment rules, please do not hesitate to contact me on [insert telephone number of partner].

Yours faithfully,

**[Insert partner name]**

1. The similar business test only applies to tax losses and capital losses incurred in income years commencing on or after 1 July 2015. [↑](#footnote-ref-2)
2. The COT allows companies with unequal rights to dividends, capital distributions or voting power to satisfy the COT where certain conditions relating to unequal share structures are met under Division 167 of the ITAA 1997. [↑](#footnote-ref-3)