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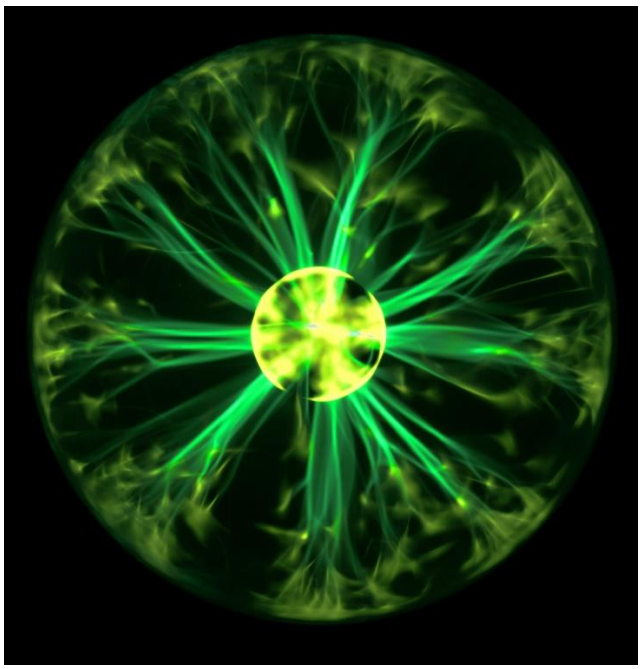


Tax Insights

Tax loss carry back legislation passed

Snapshot

The 2020-21 Federal Budget handed down on 6 October 2020 included a **temporary loss carry back measure**.

On 7 October 2020, the Government introduced Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020, dealing with the key Budget tax measures:

- Accelerating the **personal income tax cuts**;
- Temporary **loss carry back**;
- Increasing the **small business entity turnover threshold** for certain concessions;
- Enhancing the **R&D Tax Incentive;** and
- Temporary **full expensing of depreciating assets.**

The Bill was passed by the Parliament on 9 October 2020. This Tax Insight on the loss carry back measure is based on the detail as contained in the above Bill.

Relevance

This Tax Insight on tax loss carry back is relevant to you if:

- Your aggregated turnover is less than $5 billion,
- Across the four years from 2018-19 to 2021-22 years, you have or expect to have one or more tax loss years which occur after one or more years in which income tax was paid,
- You want to accelerate utilisation of those tax losses so as to be able to claim a refund for the 2020-21 or 2021-22 years.

Overview

Under the temporary loss carry back measure, a corporate tax entity is able to **choose** to carry back income tax losses (but not capital losses) to prior years. In broad terms, the rules apply to corporate tax entities that:

- Have aggregated turnover of **less than $5 billion** in the relevant loss year;
- Incurred a tax loss in any of the 2019-20, 2020-21 or 2021-22 years (referred to as **loss years**); and
- Have an "income tax liability" for any of the 2018-19, 2019-20 or 2020-21 years (referred to as **tax liability years**).

Where the rules are applied, a refundable tax offset will be available in either the 2020-21 or 2021-22 years. That is, even though a tax loss in the 2019-20 year may generate a tax offset, that offset will only be able to be claimed in the 2020-21 or 2021-22 years. Thus, the earliest that the offset would become available is upon lodgment of the tax return for the 2020-21 year, after completion of the 2020-21 year.

The amount of the tax offset for each tax liability year is limited to the income tax liability for that year. Further, the tax offset cannot exceed the franking account balance at the end of the year in which the offset is claimed.

The carry back measure only applies where the taxpayer chooses: the existing tax loss carry forward rules continue to apply in respect of tax losses that are not applied under the carry back measures.

A specific loss carry back anti-avoidance rule will be introduced, and amendments will also be made to Part IVA (the general anti-avoidance provisions) to address the loss carry back measure.

Whilst the measure applies to a corporate tax entity, which includes a corporate limited partnership and a public trading trust, references below are generally made to a company.

Entitlement to a loss carry back tax offset

A company can claim a **loss carry back tax offset** in either the 2020-21 or 2021-22 years, which are referred to as the **current year**.

For the purpose of calculating a **loss carry back tax offset** for the **2020-21** year:

- A tax loss (if any) incurred in the **2019-20 year** can be carried back to the 2018-19 year, if that year is a tax liability year; and
- A tax loss (if any) incurred in the **2020-21** year can be carried back to the 2018-19 or 2019-20 years, provided either or both of those years are tax liability years.

For the purpose of calculating a **loss carry back tax offset** for the **2021-22** year:

- If 2019-20 or 2020-21 year losses remain or if there is a tax loss in the 2021-22 year, a tax loss can be carried back to the 2018-19, 2019-20 or 2020-21 years, provided any of those years are tax liability years.

The following conditions are also to be satisfied in respect of the current year in which the company seeks to claim a loss carry back offset:

- The entity is a company throughout the relevant year; and
- For that year and each of the 5 preceding years, any of the following are satisfied:
    - The company has lodged its income tax return for the year;
    - The entity was not required to lodge an income tax return; or
    - The Commissioner has made an assessment of the entity's income tax for the year.

Steps to calculate offset amount

The principal steps in calculating a loss carry back tax offset for the current year are:

- To make a **loss carry back choice**;
- To calculate the **loss carry back tax offset components** for each tax liability year; and
- To calculate the **loss carry back tax offset** for the current year.

Loss carry back choice

Within the above framework, a company may make a **loss carry back choice** in the **2020-21 or 2021-22** years, which specifies:

- The eligible **loss year** in which the loss was incurred;
- The eligible earlier **tax liability year** to which the loss will be carried back; and
- The **amount** of the loss to be carried back.

The company can make a choice to carry back a tax loss from one or more eligible loss years, and for each particular loss to be carried back, it can be carried back to one or more earlier tax liability years. This choice is expected to be made as part of lodging the tax return for the current year.

This choice could variously involve:

If the loss year is	The loss can be carried back to any of these years which are tax liability years
2019-20	2018-19 year
2020-21	2018-19 and / or 2019-20 years
2021-22	2018-19, 2019-20 and / or 2020-21 years

Loss carry back tax offset components

It is necessary to calculate the **loss carry back tax offset components** for each tax liability year. The loss carry back tax offset components for a particular tax liability year are calculated as follows:

- Step 1: determine the amount of a tax loss which has been chosen to be carried back from a particular loss year to a particular tax liability year;
- Step 2: reduce the step 1 amount by the company's net exempt income (if any) for the particular tax liability year; and
- Step 3: multiply the step 2 amount by the corporate tax rate applicable for the particular loss year. Note that smaller companies may have paid tax at rates less than 30% in relevant years.

As the carry back mechanism involves a refund of prior year tax paid, the loss carry back tax offset component for a particular tax liability calculated above cannot exceed the company's income tax liability for the particular tax liability year. Where tax losses are carried back to more than one tax liability year, the above three-step process to calculate the loss carry back tax offset components is to be undertaken for each tax liability year.

Amount of the loss carry back tax offset

The loss carry back tax offset is equal to the sum of the loss carry back tax offset components, subject to one further step. The offset is limited by the **franking account balance at the end of the current year**.

If the offset exceeds the franking account balance as at the **end of the current year**, the loss carry back tax offset amount is reduced to the franking account balance. Subject to any reduction attributable to the franking account, this is the amount of the tax offset.

Refundable tax offset

The loss carry back tax offset is a refundable tax offset (to be added to the table in section 67-23, *Income Tax Assessment Act 1997*). However, the Commissioner's usual practice is to apply any refund amount arising from an offset towards paying another amount the company owes to the Commissioner before a cash refund would be paid.

Integrity measures

The loss carry back regime will be subject to a specific anti-avoidance provision, and in addition, specific amendments will be made to Part IVA which could also apply. The continuity of ownership, same business tests and similar business tests which apply to tax loss carry forward do not apply to loss carry backs.

The specific anti-avoidance provision has various requirements but is directed towards loss trafficking type situations involving circumstances under which there is a change in control of the company, and a purpose to obtain a loss carry back tax offset.

Less than $5 billion turnover

The loss company carry back measure is only available to companies with aggregated turnover (as defined) that is less than $5 billion. More specifically, a company cannot carry back a tax loss unless the company carries on a business in the loss year and is:

- A small business entity (under Subdivision 328-C) **for the loss year** (broadly, a company with aggregated turnover of less than $10 million); or
- Would have been a small business entity **for the loss year** under Subdivision 328-C if certain modifications were made to under Subdivision 328-C. The modifications broadly adopt the existing framework of Subdivision 328-C but **replace** references to $10 million **with references to $5 billion**.

For example, consider a company (which is **not** a small business entity) which is:

- Carrying on a business in all relevant years;
- Seeking a loss carry back tax offset for the **2020-21** year (current year);
- In respect of a loss incurred in the **2019-20** year (loss year); and
- Where that loss is to be carried back to the **2018-19** income year (tax liability year).

The test is whether the company meets the modified requirements in Subdivision 328-C **for the loss year,** in this case being the **2019-20** year. In broad terms, the question is essentially whether in:

- The loss year; **or**
- The year immediately preceding the loss year;

the aggregated turnover of the company for **either** of those years was less than $5 billion.

For example, where the loss year is the 2019-20 year, the issue is whether the aggregated turnover for **either** the 2019-20 or the 2018-19 years was less than $5 billion.

Aggregated turnover

Aggregated turnover is defined to mean the sum of the annual turnovers for a particular year of:

- the company;
- an entity that is **connected** with the company at any time during the year; and
- an entity that is an **affiliate** of the company at any time during the year.

Care will need to be taken to identify all entities that are **connected with** or an **affiliate of** the company.

Relevantly, annual turnover is defined as the total **ordinary income** that the entity derives in the relevant year in the **ordinary course of carrying on a business**.

Next steps

Suggested next steps to determine the potential impact of the loss carry back measure:

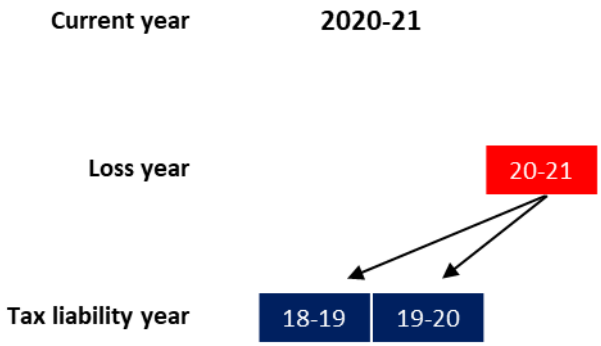
- Test whether the company has aggregated turnover of less than $5 billion for the relevant loss year;
- Identify which of the 2019-20, 2020-21 or 2021-22 years **are or are expected** to be **loss years**;
- Identify which of the 2018-19, 2019-20 or 2020-21 years **are or are expected** to be **tax liability years**;
- A loss carry back offset may be available if an eligible loss year occurred **after** a tax liability year;
- Determine the **estimated franking account balance** as at the end of 2020-21 or 2021-22;
- Model the range of the loss carry back offset amount that could be claimed for the 2020-21 or 2021-22 years:
    - For example, will the expected franking account balance as at the end of 2020-21 or 2021-22 limit the loss carry back offset amount;
    - Is there any dividend planning to be addressed prior to the end of 2020-21 or 2021-22;
- Consider the impact, if any of the immediate expensing measure announced in the Budget on the expected tax loss / tax liability position for the 2020-21 or 2021-22 years;
- Consider the franking account impact of the tax offset (franking debit) in the year that the loss carry back offset arises; and
- Compare the cash flow, franking and other consequences with the alternative of claiming the tax losses by way of the regular tax loss carry forward deduction, including the operation or potential operation of the continuity of ownership, same business tests and similar business tests.

Examples

Set out below are a number of examples to demonstrate the operation of the measures.

Example 1: Company A

This is an example of a tax loss from one loss year which is carried back to two tax liability years:



Current year & loss year	2020-21	
	Tax loss = $900,000	
	Franking account balance at year end = $280,000	
	Tax rate = 30%	
Tax liability years	2018-19	Income tax liability = $120,000
		Net exempt income = $5,000
	2019-20	Income tax liability = $210,000
Choice	Carry back $405,000 of 2020-21 tax loss to 2018-19	
	Carry back $495,000 of 2020-21 tax loss to 2019-20	

Company A's **loss carry back tax offset components** for the 2020-21 year are $268,500, worked out as follows:

- An **offset component for the 2018-19 income year** of $120,000, calculated by starting with the $405,000 carried back, reducing that at step 2 by $5,000 = $400,000, and multiplying the result by 30% = $120,000 (which is equal to the tax paid amount); and
- An **offset component for the 2019-20 income year** of $148,500, calculated by multiplying the $495,000 carried back by 30% = $148,500 (which is less than the tax paid of $210,000).

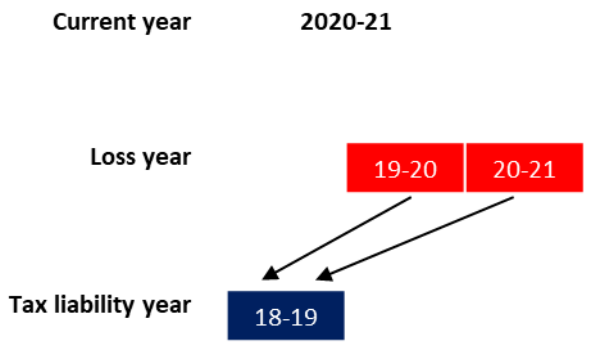
The sum of the 2 components is **$268,500.**

This is less than Company A's $280,000 franking account balance at the end of the 2020-21 year. If the sum of the 2 components had exceeded that franking account balance, the amount of the offset would have been limited to that balance.

Company A's loss carry back tax offset for the 2020-21 year is $268,500.

Example 2: Company B

This is an example of tax losses from two loss years which are carried back to one tax liability year:



Current year & loss year	2020-21	
	Tax loss = $500,000	
	Franking account balance at year end = $550,000	
	Tax rate = 26%	
Loss year	2019-20	Tax loss = $2,000,000
		Tax rate = 27.5%
Tax liability year	2018-19	Taxable income = $5,000,000
		Tax rate = 27.5%
		Income tax liability = $1,375,000
Choice	Carry back $500,000 of 2020-21 tax loss to 2018-19	
	Carry back $2,000,000 of 2019-20 tax loss to 2018-19	

Company B's **loss carry back tax offset component for the 2018-19 year** is $680,000:

- Calculated as $500,000 (tax loss for the 2020-21 year) carried back and multiplying that by 26%, being the relevant tax rate for the 2020-21 year (loss year) = $130,000; and
- Calculated as $2M (tax loss for the 2019-20 year) carried back and multiplying that by 27.5%, being the relevant tax rate for the 2019-20 year (loss year) = $550,000.

The sum of the 2 components is **$680,000**, which is:

- **Less than** the tax paid in 2018-19; and
- **More than** Company B's franking account balance ($550,000) at the end of the 2020-21 year.

Company B can modify its choice to reduce the amount of losses carried back. **Company B's loss carry back tax offset for the 2020-21 year is $550,000.** Company B will have unutilised losses to be carried forward.

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