

# Alert

## Greater access to tax losses

### Legislation broadens the scope of the 'same business test' to 'similar business test', aims to improve access to tax losses, particularly for entrepreneurs.

The Treasury Laws Amendment (2017 Enterprise Incentives No.1) Bill 2017 has passed both Houses of Parliament and is awaiting Royal Assent.

The Bill contains the 'similar business test' that is intended to allow companies greater access to their carried forward tax losses, compared to the existing 'same business test' (SBT) which is applied strictly in practice by the ATO, as can be seen from the Taxation Ruling TR 1999/9.

In general, tax losses of a company can be carried forward and recouped in a later year of income if the company passes:

- (a) The continuity of ownership test, or if that is failed
- (b) The same business test.

#### The 'similar business test' explained

Under the 'similar business test', four factors must be taken into account in determining whether a company carries on a similar business in the year of loss recoupment to that carried on immediately before the change in ownership or control that caused the company to fail the continuity of ownership test. These factors are:

- The extent to which the assets (including goodwill) used in the current business to generate assessable income were also used in the company's former business to generate assessable income
- The extent to which the activities and operations from 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
- 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.

#### Evaluation of 'similar' business

The provisions do not specify the weight to be placed on each of the factors. Consequently, in evaluating each of the factors and in forming a conclusion as to whether the current business is a similar business to the former business, there is a level of judgement required. The relative importance to be placed on each of the factors will therefore depend on facts and circumstances.

These factors overlap to a certain extent with the factors that the ATO took into account in the context of the SBT.

It is stated in the explanatory memorandum to the Bill that "as with the same business test, whether the current business is similar to the former business is a question of fact." This calls into question as to whether the "similar business test" will in practice be more accessible as intended. For instance, at paragraph 1.23:

"The four factors allow for differences between the current and former businesses that result from attempts to grow or rehabilitate the business. However, they also mean that there should be a clear similarity in the business identity of the operations of the former business and the current business. If a business changes its essential character or identity, or if there is a sudden or dramatic change in the business brought about by either the commencement, the acquisition or the cessation of activities, then the business would fail the similar business test."

While the level of flexibility built into the provisions is desirable, it is nonetheless conceivable that the ATO and tax advisers may reach different conclusions based on the same facts and circumstances.

### Practical application: ATO guidance

The ATO has issued Law Companion Ruling LCR 2017/D6, which outlines the Commissioner’s views as to how the similar business test would operate. It is stated that in his view, the similar business test operates in a way that is comparable to the SBT (without the new transactions or activities limbs of the same business test). Although the new rules do not incorporate the new transactions or activities limbs of the SBT, it is made clear that such changes are still relevant when considering whether the similar business test is satisfied.

The examples contained in the explanatory memorandum as well as LCR 2017/D6 indicate that the new rules may still be applied rather strictly. For example, Example 2 of LCR 2017/D6 indicates that a courier business (delivering letters, parcels and paperwork) may fail the similar business test when it starts to derive assessable income from delivering food without any significant accompanying change in its assets, processes etc., while a different conclusion was reached in Example 1 where significant changes to processes and assets used are involved.

### Impact to businesses

Although the new test is intended to “encourage[s] entrepreneurship by allowing companies to use losses in a wider range of circumstances and encourages companies to seek out new business opportunities and return to profitability”, it remains to be seen whether it will in fact be easier to apply in practice.

The new rules apply to tax losses incurred by companies for income years starting on or after 1 July 2015.

Please contact us for more information.



**Rosalind Myint**

Partner, Tax

T +61 2 8059 6865

E rmyint@shinewing.com.au

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