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GM TAXATION & ACCOUNTING

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Loss Carry Back Rules Announced

After being announced in last year's Federal Budget, legislation has recently been introduced to implement the carry back of tax losses to prior years. Broadly, the rules are targeted at generally profitable small companies going through a temporary downturn and will apply to assessments relating to the 2012-13 and future income years. The proposed mechanism to implement the measure is in the form of a new refundable loss carry-back tax offset. In summary, the key features are as follows:

- The tax offset is only available to corporate tax entities (ie companies or entities taxed like companies).
- The refund of the previously paid taxes will not require amendments of prior year tax returns.
- Tax losses can only be carried back to be offset against income tax paid in the preceding 2 income years (as a transitional measure, tax losses arising in 2012-13 can only be carried back one year to be offset against income tax paid in 2011-12).
- Only tax losses can be carried back (capital losses are not eligible).
- The tax offset is capped to the *lesser* of the following amounts:
  - the tax value of the amount of tax loss the entity chooses to carry back;
  - previously paid taxes in the preceding income years;
  - the amount of the loss in the current year;
  - the company's franking account balance at the end of the current year; and
  - a quantitative cap of $1m multiplied by the applicable corporate tax rate of 30% (ie $300,000).

While there is no requirement for an eligible loss to be carried back to the earliest year first, or that the earliest loss is carried back first, the deduction of prior year carried forward tax losses must be applied first before working out the loss carry-back tax offset. Any losses that remain after working out the loss carry-back tax offset can still be carried forward as a deduction in future income years.

EM Example

The Explanatory Memorandum (EM) accompanying the Bill contains various examples illustrating the application of the loss carry-back rules in different circumstances. The following is an example of a common situation and is based on Example 6.1 of the EM:

- AusCo Pty Ltd (AusCo) incurs a $5m tax loss in 2015-16;
- AusCo was in a taxable position and paid taxes in all 3 preceding income years; and
- AusCo's franking account balance at the end of 2015-16 is $240,000.

Income year	Taxable income/(loss)	Tax liability	Refundable tax offset	Losses carried forward
2012-13	$300,000	$90,000		
2013-14	$500,000	$150,000		
2014-15	$2m	$600,000	$0	$0
2015-16	($5m)	$0	$240,000	$4.2m

AusCo chooses to carry back its tax losses incurred in 2015-16 against the tax liabilities of 2013-14 and 2014-15. Despite tax losses of $5m, AusCo can only carry back tax losses up to a maximum of $800,000 (with a tax value of $240,000) since the maximum amount it can carry back is limited to its franking balance at the end of the 2015-16 year, which is less than the maximum cap of $1m. The maximum tax offset available to AusCo in 2015-16 is therefore $240,000.

A balance of $4.2m of tax losses for the 2015-16 year remains unused and can be carried forward to be applied against future taxable income.

AusCo also cannot choose to carry back the loss amount against the tax liability paid in 2012-13 as this income year does not fall within the time limit of 2 income years preceding the loss making year.

There will also be a debit to the company's franking account for each loss carry-back tax offset claimed. The debit is recorded when the assessment of the refundable tax offset is made.

For example, assume a loss carry-back tax offset was claimed in the 2015 income year. The debit to the franking account will be recorded in the 2016 income tax return (generally, this is the date on which the company's 2015 income tax return was lodged).

We will be monitoring our corporate clients 2013 tax position to see if they can access these loss carry back rules and would welcome the opportunity to talk to you before 30 June if you believe you may be able to access these rules to claw back tax paid in 2012.

A Legal Document Costs A Taxpayer His CGT Small Business Concessions!

In a recent case1, the Administrative Appeals Tribunal (AAT) has decided that a CGT asset was disposed of for the purposes of CGT event A1 when a Heads of Agreement was executed and not when the formal Contract of Sale was executed.

Heads of Agreement are generally considered to be non-binding documents outlining the main issues relevant to a tentative contractual agreement. However, this is by no means a settled issue because where there is an intention by the parties to create binding contractual relations through a Heads of Agreement, case law suggests that courts are increasingly more willing to hold that the document is binding and enforceable.

In this case, a pro-forma Heads of Agreement was prepared by a licenced real estate agent and was executed by the parties before the legal representatives from both parties were involved in further negotiation and eventual execution of a formal Contract of Sale.

The agent testified that it was long-standing practice in the industry for an intending purchaser and vendor to enter into an in-confidence period of exclusivity during which the intending purchaser used professional advisers to carry out due diligence. The parties to a Heads of Agreement were aware that it conferred rights to exclusive dealings and obliged confidentiality, and if the purchaser chose to proceed with the sale, the parties would be required to enter into a Sale Contract. It was also industry practice that a party which had signed a Heads of Agreement could “walk away” at any time if unsatisfied with the results of a due diligence enquiry.

Unfortunately for the taxpayer, the opening clause of the Heads of Agreement expressly stated:

"The Vendor agrees to sell to the Purchaser and the Purchaser agrees to purchase from the Vendor, the Vendor's interest in the … business described in the First Schedule below on the terms and conditions set out in such schedule".
Furthermore, the AAT found that the “Special Conditions”, which stated that the agreement may be avoided or cancelled by one or either party, are not conditions precedent to a binding contract, but rather conditions precedent to performance.

As it turned out the timing of the disposal was crucial in the taxpayer’s case. The earlier date, which is the execution date of the Heads of Agreement, applied and the taxpayer was not

[1] Confidential and Commissioner of Taxation [2013] AATA 76 (15 February 2013)

entitled to access the Capital Gain Tax (CGT) small business concessions because he did not satisfy the maximum net asset value test just before that date.

This case shows the importance seeking accounting or legal advice before a client signs any document related to the disposal of an asset. The additional tax cost of a client not being able to access the various CGT discounts and concessions will far outweigh any professional fees incurred in getting the right advice.

At [Firm] we are always available to discuss forthcoming asset sales and the advice provided in a simple phone call may save you thousands of dollars in tax.

No CGT Discount for Non-Residents

Following the 2012 Federal Budget announcement, the Government has just released draft legislation to remove the CGT Discount for non-residents. The proposed measures will apply where an individual has a discount capital gain, including a discount capital gain as a result of being a beneficiary of a trust, from a CGT event that occurred after 8 May 2012 and the individual was a foreign resident or a temporary resident at any time on or after 8 May 2012.

In summary, the effect of the measure will be to:

- retain the full CGT discount for discount capital gains of foreign resident individuals to the extent the increase in value of the CGT asset occurred prior to 9 May 2012;
- remove the CGT discount for discount capital gains of foreign and temporary resident individuals accrued after 8 May 2012; and
- apportion the CGT discount for discount capital gains where an individual has been an Australian resident and, a foreign or temporary resident, during the period after 8 May 2012. The discount percentage will be apportioned to ensure the full 50% discount is applied to periods where the individual was an Australian resident.

Importantly, where an Australian resident becomes a foreign resident, the amendments will only apply in circumstances where the assets are taxable Australian property, including where the individual has chosen to disregard any capital gains under CGT event I1 triggered by their change in residency status on making the election under s 104-165.

In addition, the proposed measures will ensure capital losses will continue to be offset against capital gains and net capital losses may still be carried forward.

It is important to note that the draft legislation also provides that the amendments are only intended to affect the discount percentage applied to a discount capital gain. These amendments are not intended to affect other rules in the CGT regime, such as the application of the main residence exemption.

Date of effect

The proposed amendments will apply to CGT events that occur after 8 May 2012. However, the portion of gains accrued prior to 9 May will still be eligible for the full CGT discount if the taxpayer undertakes a **market valuation** of the asset as at 8 May 2012.

It is therefore important that non-residents undertake market valuations of their Australian assets as at 8 May 2012. Given the difficulty in undertaking these valuations too far after the date, we recommend that if it has not been undertaken already, that it is done now. If you require any assistance with this please call us.