Attachment E

LOSSES ON ENTITY INTERESTS IN LOSS COMPANIES

The integrity of the entity tax system and the revenue base will be protected by denying for tax purposes losses on interests held by entities interposed between a loss company and its ultimate individual owners where there is a change in the majority ownership of the company. The measure will reduce the scope for multiple recognition of losses by the tax system and is consistent with Recommendation 6.9(b) of *A Tax System Redesigned*.

Key features

The measure will:

- apply to all entity interests apart from insignificant equity interests in loss companies of less than 10%;
- apply to equity and debt interests;
- prevent losses on inter-entity interests but only to the extent of any realised or unrealised losses in the company;
- implement related changes to the continuity of ownership test. Under the changes a company will fail the test where there has been a substantial change in the direct or indirect ownership of the company. A failure will cause the company's losses to be subject to the same business test and provide an appropriate trigger for the inter-entity loss measure;
  - A 'saving' provision will preclude a loss that has failed the continuity of ownership test from being subject to the same business test in certain circumstances where the loss has not been substantially duplicated and the company's majority underlying ownership has remained the same;
- delay the commencement time for the measure announced on 21 September 1999 (Attachment Q – duplication of unrealised losses) that is contained in the *New Business Tax System (Integrity and Other Measures) Bill 1999* currently before Parliament. This will synchronise the commencement time of the unrealised loss measure with the inter-entity loss measure outlined above, and hence, significantly reduce compliance costs.
  - Companies would be required to determine their unrealised net losses at different times in respect of the 2 measures if separate commencement times are maintained.

Commencement date

The measure and the measure announced in Attachment Q on 21 September will apply in respect of companies that experience substantial changes in their ownership after 1pm, Australian eastern summer time, 11 November 1999.

Why the change is needed

The same business test allows a company whose majority underlying ownership has changed to carry forward its losses where the company continues to carry on the same business. Where one or more entities are interposed between the company and its ultimate owners, the losses will be multiplied, the extent of multiplication depending on the number of interposed entities. This is because the losses are reflected in the value of interests in each of those interposed entities.

The measure will reduce the scope for multiple recognition of losses by the tax system.