Similar business test - greater flexibility or continued uncertainty?

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In brief

Historically, the need to satisfy the Same Business Test (SBT) by a company which has had a majority change in ownership in order to for it to deduct a carry forward loss has sometimes discouraged companies from innovating or adapting to changing economic circumstances. The new Similar Business Test (SiBT), which has been designed as a more flexible test to address some of the limitations associated with the SBT, has finally completed its passage through Parliament and is now awaiting Royal Assent.

While the alternative SiBT might clear the way for some companies to readily utilise past losses, practical issues may emerge for others in determining how "similar" a current business is to its former business.

In detail

The company loss rules are complex. However, in simple terms, a company can broadly deduct its tax losses if it maintains the same underlying majority owners. Alternatively, a company which fails to maintain continuity of majority ownership will be able to deduct its losses if it can satisfy the SBT. Generally, a company will satisfy the SBT if it carries on the same business in the income year in which it seeks to utilise its loss as it had carried on immediately before the change of ownership (the "test time").

Additionally, a company cannot satisfy the SBT if it meets the "negative tests" which relate to the following:

- deriving assessable income from a business of a kind that was not carried on before the test time (new business test); or
- deriving assessable income from a transaction of a kind that had not been entered into in the course of its business operations before the test time (new transaction test).

Historically, the need to satisfy the SBT has potentially discouraged loss companies from raising new capital and innovating or adapting to changing economic circumstances because such activities could result in prior year tax losses being wasted due to the new business and new transaction tests. The new SiBT seeks to overcome these limitations and provide flexibility.

Under the new SiBT, to determine whether the SiBT is satisfied various factors need to be considered including the following.

Same assets used to generate income	The extent to which assets used in the current business to generate assessable income were also used in the former business to generate assessable income.
Assessable income generated from same activities and operations	The extent to which the activities and operations from which the current business generates assessable income are also the activities and operations from which the former business generated assessable income.
Identity of business	A comparison of the identity of the current business and the former business.
Development of former business	Consideration of the degree of connection and continuity between the former business and the current business to evaluate the extent to which any changes result from the development or commercialisation of assets, products, processes, services or marketing or organisational methods of the former business.

The SiBT has been designed as an alternative, more flexible test to the SBT. Specifically, it addresses the inherent limitations associated with the SBT new business and transactions tests, however there remains an element of uncertainty in its application. In particular, the determination of how "similar" a current business is to the former business will be a question of fact and degree and may not always be easily determined. Furthermore, as noted, there are various factors which must be considered in assessing whether the SiBT has been satisfied. This will require a comparison and weighing up of each of the factors, the relative importance of each of the factors will determine if the SiBT has been met on an overall basis. Applying the SiBT is, therefore, in practice, prone to some subjectivity.

The Australian Taxation Office (ATO) has released a Draft Law Companion Ruling LCR 2017/D6, which provides guidance on the SiBT. Now that the legislation has been passed, it can be expected that this LCR will be issued in final form shortly. The publishing of ATO guidance is welcomed, however it fails to fully address the complex nature of satisfying the SiBT.

The new SiBT has an element of retrospectivity, but only in relation to tax losses or net capital losses that were made by a company in an income year(s) commencing on or after 1 July 2015. Accordingly, companies that had previously sought to rely on the SBT and failed it when seeking to recoup tax or net capital losses incurred in the 2015-16 income year (or subsequent income years) should revisit their position in light of the new SiBT.

The takeaway

Due to the fact specific nature of the SiBT, affected loss companies should exercise caution and seek advice to assess whether their particular facts and circumstances satisfy the test. Furthermore, observing that one of the key areas that attracts the ATO's attention is correctly applying the loss rules, regard must be given to ensuring that relevant information including records are present to substantiate any claims made.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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