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Abstract

This article examines the interpretation and application of the continuity of business tests (generally known as the "same business test") for the carry forward of losses and the deduction of bad debts. It provides a critique of the Australian Taxation Office (ATO) analysis of the old provisions. It then makes suggestions on how to approach the new provisions which have been rewritten by the Tax Law Improvement Project.

Keywords

business tests, tax law, Australia, income tax

THE CONTINUITY OF BUSINESS TESTS FOR CARRYING FORWARD LOSSES



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This article examines the interpretation and application of the continuity of business tests (generally known as the “same business test”) for the carry forward of losses and the deduction of bad debts. It provides a critique of the Australian Taxation Office (ATO) analysis of the old provisions. It then makes suggestions on how to approach the new provisions which have been rewritten by the Tax Law Improvement Project.

INTRODUCTION

The Income Tax Assessment Act 1997 (Cth) (“the 1997 Act”) was enacted in March 1997, being the first instalment of the simplification rewrite which will gradually replace the Income Tax Assessment Act 1936 (Cth) (“the 1936 Act”). Among the provisions redrafted were those governing a company’s ability to carry forward losses. There are two tests that determine whether a company can carry forward losses and deduct bad debts. The company must have continuity of more than 50% of its beneficial ownership (continuity of ownership test); or, failing that, it must carry on the same business as it did before the majority change in beneficial ownership (continuity of business tests).

This article examines the continuity of business tests. Its aims are:

- 1 To analyse the new law according to the interpretation of the old law contained in Taxation Ruling 95/31;
- 2 To evaluate the effectiveness of the simplification rewrite in overcoming the interpretational difficulties caused by the old law; and
- 3 To provide some guidance on how to approach the continuity of business tests.

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As the interpretation of the old law is generally to apply to the new law, it is relevant to examine TR 95/31 which was labelled the biggest tax ruling of 1995 and “a win for business”.¹ On the other hand, it was also criticised as “an incorrect ruling discussing a flawed piece of legislation” at the taxpayers’ expense.² It is also relevant to review judicial consideration of the old law, which has been inadequate in its pronouncements on the continuity of business tests. The caution against major tax policy changes in the rewrite is reflected in the new Subdivision 165-E (of the 1997 Act), which has not resolved all the problems arising under the old s 80E (of the 1936 Act).

The new subdivision 165-E (the redrafted s 80E of the 1936 Act) enables a company to utilise its tax losses and bad debts after failing the continuity of ownership tests in subdivision 165-D (the redrafted s 80A of the 1936 Act).³ In order to satisfy the subdivision 165-E continuity of business tests (which are stipulated in s 165-210), a company must carry on the same business, conduct no additional businesses and enter into no new transactions after a change in its ownership and/or control.⁴

New law v old law

The 1936 Act contained separate but virtually identical continuity of business and continuity of ownership tests. These are set out in Table 1 below.

For the purposes of simplicity and certainty, the 1997 Act has restructured and consolidated the old provisions in relation to tax losses. Consequently, uniform tests of continuity of ownership (subdivision 165-D) and continuity of business (subdivision 165-E) now govern:⁵

- deductions of current and prior year losses (s 165-10, s 36-25);
- intra-group transfers of income and net capital losses (subdivision 170-A).

¹ Abbey P, “A win for business? The continuity of business test: TR 95/31” (1995) 46 *Weekly Tax Bulletin* at 937.

² Allerdice R, “Review of current developments in tax losses” (May 1996, Queensland State Convention) *Taxation Institute of Australia* 9 at 15.

³ 1997 Act, ss 165-10 and 165-13.

⁴ Bevan C, “Love’s labour’s lost” (1997) 32 *Taxation in Australia* 91 at 93.

⁵ Bevan C, *ibid* at 96; Longes M, “Current issues in the utilisation of losses” (1996-97) 1 *Taxation Institute of Australia Convention Papers* 271 at 275.

Table 1

Continuity of Ownership test	Continuity of Business test	Utilisation of a company's tax losses
s 80A	s 80E	Prior year losses <ul style="list-style-type: none"> • carry forward income losses: ss 79E, 79F, 80, 80 AAA, 80AA • carry forward net capital losses: s 160ZC(5) (see TD 92/175) • intra-group transfer of income losses: s 80G(6)(d)(ii), (e)(ii)
s 50D(2)	s 50D(4)(6)(8)	<ul style="list-style-type: none"> • current year losses - calculation of eligible notional loss
s 50H	s 160ZP(9A)	<ul style="list-style-type: none"> • intra-group transfer of net capital losses
s 63A	s 63C	<ul style="list-style-type: none"> • deduction of bad debts

Table 2

1997 Act	1936 Act	
s 165-210(1)	s 80E(1)(b)	Same Business Test (SBT) - whether the company carries on the <i>same business</i> throughout the same business test period as it carried on <i>immediately</i> before the test time.
s 165-210(2)(a)	s 80E(1)(c)	New Business Test (NBT) - whether the company derives assessable income at any time during the same business test period from a <i>business of a kind</i> that it did not carry on before the test time.
s 165-210(2)(b)	s 80E(1)(c)	New Transaction Test (NTT) - whether the company derives assessable income at any time during the same business test period from a <i>transaction of a kind</i> that it had not entered into <i>in the course of its business operations</i> before the test time.
s 165-210(3)	s 80E(2)	Anti-avoidance Test - whether the company commences a business or initiates a transaction prior to the test time in order to satisfy the above three tests. ⁶
s 165-210(4)	No equivalent	Expenditure Test - whether the company <i>incurs expenditure</i> during the same business test period from carrying on new businesses or entering into new transactions before the test time.

⁶ Williamson C and Bernhardt S, "S 80E: does 'same business' mean 'identical business'? - A critical analysis of TR 94/D42" (1995) *CCH Journal of Australian Taxation* at 2; Boccabella D, "Continuity of business tests under the Income Tax Assessment Act: policy and technical issues" 8th Annual Australasian Tax Teachers Association Conference Paper, 18-20 January 1996 at 6 ("ATTA Conference Paper").

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LEGISLATIVE FRAMEWORK OF SUBDIVISION 165-E⁷

Section 165-210 has five limbs or subsidiary tests. These are set out in Table 2 above.

Most of the italicised phrases in Table 2 give rise to interpretational issues. These have been examined in TR 95/31. This ruling about s 80E of the 1936 Act is taken to be a ruling about s 165-210 of the 1997 Act, so far as the two provisions express the same ideas.⁸ For instance, "same business test" is the generic name for s 165-210, even though it is itself one of the various tests contained in s 165-210 which are based on the continuity of business.

Compare and contrast the three tests

a) *Common elements*

- The *test time* (equivalent to "the change" in s 80E) is the time when the continuity period ends. In other words, it represents the point in time when the change in the beneficial ownership of a company results in failing the continuity of ownership test.
- The *same business test period* is the period during which the continuity of business tests must be satisfied.⁹ Its meaning is equivalent to that of "the year of income" in s 80E.

b) *Differences*

Section 165-210(1) refers to "*throughout the same business test period*",¹⁰ whereas s 165-210(2) refers to "*at any time during the same business test period*".¹¹

⁷ See appendix for the full text of s 80E of the 1936 Act and s 165-210 of the 1997 Act.

⁸ 1997 Act s 1-3. However, the explicit preservation of tax rulings alone creates uncertainty as to whether existing case law is still relevant to the 1997 Act. It is arguably undesirable that the ATO is able to fill such "interpretation vacuum" with its rulings: Lehmann G, "Old dog, new tricks" (1997) 31(10) *Taxation in Australia* 516 at 518.

⁹ Longes M, above n 5 at 275. See also 1997 Act, s 995-1.

¹⁰ This was formerly expressed as "at all times during the year of income" in s 80E(1)(b).

¹¹ This was formerly expressed as "at any time during the year of income" in s 80E(1)(c). This difference seems to have been overlooked by the ATO. Moreover, the question of whether "at all times" in (1)(b) requires "day-by-day" activity in the carrying on of a business was left open in *Northern Engineering P/L v FCT* 80 ATC 4025 at 4029 per Toohey J.

In addition, the phrase “*immediately before* the test time” is not used consistently in the provision. By reducing the significance of the word “immediately” in TR 95/31, the Australian Taxation Office (“ATO”) has rendered the task of resolving the overlap between the multiple tests in s 165-210 more difficult.

Application of s 165-210

Prior to analysing the ATO’s approach, it is useful to identify the various circumstances in which s 165-210 may be infringed. These involve the re-arrangement or reorganisation of a company’s commercial activities by:¹²

- discarding some or all of its existing activities;
- adding to its existing activities;
- retaining its existing activities on a different scale (eg, expansion or contraction) and/or other variations.

TR 95/31: THE ATO'S INTERPRETATION

An hypothetical scenario¹³ has been designed to illustrate the effects of applying the different interpretations. This is set out in Table 3.

Table 3

CASE STUDY	
<i>December 1989:</i>	
Restaurant Pty Ltd (R Co – owned by a Japanese couple) was incorporated and began to operate two dine-in restaurants (featuring Japanese and Italian food) in the same shopping centre. The restaurants were quite profitable until the opening of other food shops.	
<i>March 1992:</i>	
Following its losses, R Co was sold to a Chinese couple who had been operating a <i>Chinese restaurant</i> in the same area. The names of the company and the restaurants remained intact, however several changes were made during the year:	
<ul style="list-style-type: none"> • Take-away service was added to the <i>Japanese restaurant</i>. • R Co and the owner of an ice-cream parlour entered into a lease agreement, which allowed the latter to use part of the premises of the <i>Italian restaurant</i> for his business. 	

¹² Boccabella, above n 7 at 13; Franks S, “Company losses” (1996) *Weekly Tax Bulletin* 24.

¹³ The original example in TR 95/31 (paras 105-111) has been substantially modified to accommodate more issues arising from the continuity of business tests.

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The Commissioner's views on the continuity of business tests will now be examined in detail.

1 SAME BUSINESS TEST ("SBT"): S 165-210(1)

This is the primary test. There is a positive requirement that the same business be maintained at two relevant points in time - namely, immediately before the test time (ie, change in ownership) and the same business test period (ie, the recoupment period).¹⁴

a) Meaning of "business"

"Business" has been equated to "*overall business*" for the purposes of SBT, which represents the entirety or totality of a company's business operations.¹⁵ This means that all of the company's activities are surveyed, but considered as a whole to determine their effect on the overall identity of the company's business. Thus R Co in the hypothetical scenario would be treated as carrying on only one business prior to the ownership change in March 1992, although there was a "Japanese restaurant business" and an "Italian restaurant business".

This amalgam of discrete businesses approach is difficult to apply.¹⁶ This is because the ATO refuses to identify the overall business merely by reference to the heart or core of the business,¹⁷ while at the same time it also refuses to identify the business by general, industry-wide definitions.¹⁸

Three approaches are available when dealing with multiple businesses:¹⁹

- 1 Singular interpretation (widest): SBT is satisfied if the company retains one of its previous businesses after the test time. It has been contended that such a lenient approach be rejected.²⁰

¹⁴ The test time in the case study began in March 1992. It follows that the same business test period is from 1 July 1991 until 30 June 1992.

¹⁵ TR 95/31 at paras 5 and 25.

¹⁶ ATTA Conference Paper, above n 9 at 17; Bryant R, "Review of current developments involving tax losses" *Tax Institute of Australia Convention Papers* 28-29 September 1995, 92 at 93.

¹⁷ TR 95/31 at para 30 - See the criticisms in Abbey P, above n 1 at 937; Shaw JD and Poke AR, "The continuity of business test" (1995) *National Accountant* 56 at 57; Williamson C and Bernhardt S, above n 7 at 3-5.

¹⁸ TR 95/31 at para 56(a). See also *Fielder Downs (WA) P/L v FCT* 79 ATC 4019.

¹⁹ Williamson C and Bernhardt S, above n 7 at 14.

²⁰ *Ibid* at 16.

- 2 Plural businesses interpretation (intermediate): SBT may be satisfied if the company retains a majority of its businesses. The ATO unsuccessfully relied on this approach in *Case Y45*²¹ arguing for the application of s 23(b) of the Acts Interpretation Act 1901 (Cth).²²
- 3 Overall business approach (narrowest): This is the ATO's current approach. It seems to require the retention of all previous businesses.

Table 4 below illustrates the different outcomes reached by applying two of these approaches.²³

Table 4

Scenarios	Overall Business (ATO's current approach)	Plural Businesses (ATO's previous approach)
Discarding existing activities. ²⁴	SBT failed.	No automatic failure - depends on the proportion between the businesses retained and discarded. ²⁵
Adding to existing activities. ²⁶	SBT failed if the additional business has changed the identity of the existing overall business.	SBT satisfied as the additional business does not affect the identities of the separate existing businesses - however possible failure of NBT. ²⁷

b) Meaning of "carried on" - the "continuing business" requirement

Since the periods of comparison are the period immediately before the test time and the same business test period, it follows that a company would fail SBT if none of its businesses existed before the test time.²⁸ Accordingly, whether the business carried on after the test time is a recommencement of an

²¹ *Case Y45* (AAT Case 7272) 22 ATR 3395.

²² Section 23(b) AIA states that "words in singular number include the plural" - here, the word "business" in SBT includes "businesses".

²³ Williamson s and Bernardt C, above n 7 at 17.

²⁴ For example, if the Japanese restaurant were discarded after the test time in March 1992.

²⁵ For example, if R Co carried on 5 businesses specialising in different international food, then the termination of one Italian restaurant may not fail SBT.

²⁶ The additional Chinese restaurant business since the ownership change in March 1992.

²⁷ The interaction between SBT and NBT will be addressed later in the article.

²⁸ CCH Tax Editors, *1997 Australian Master Tax Guide* (1997 CCH Australia Ltd) at 67.

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old business, or a commencement of a new business, would depend on whether there was a complete cessation or a mere suspension of business before the test time.²⁹ Here, several factors have been provided by the courts and by the ATO to assist with the determination:

- nature of business – eg, whether the business can be conducted passively.³⁰
 - causes of inactivity – whether these are beyond the company's control.³¹
 - company's intention – eg, whether the cessation is intended to be temporary or permanent;³² whether there is intention to resume the previous business³³ (the Commissioner has imposed additional requirements that the company must intend to resume the business formerly carried on, and that the resumption must be within a reasonable time).³⁴
 - abandoning acts – eg, selling assets, sacking employees, paying out creditors.³⁵
 - remaining activities – eg, mere preservation of assets and collection of debts have no element of business.³⁶
- c) **Meaning of “same” - the “identity” requirement: does same business = identical business?**

In *Avondale Motors* it was held that the word “same”, in the context of s 80E imports *identity* and not merely similarity.³⁷ In response to the attack on its literal reading of this judicial statement in the draft ruling (TR 94/D42), the ATO has acknowledged Gibbs J's³⁸ qualification to the notion of “identical

²⁹ TR 95/31 at paras 39 and 43.

³⁰ In *Avondale Motors (Parts) P/L v FCT* 71 ATC 4101, it was held that business in dealing in motor parts and accessories is not one that can be conducted with mere passivity.

³¹ TR 95/31 at para 49; *Case U105* 87 ATC 637.

³² “Temporary” is indicative of the purpose to enable the continuation of previous business whereas “permanent” points to the purpose of abandoning the previous business: *AGC (Advances) Ltd v FCT* 75 ATC 4057 per Mason at 4072, Barwick CJ at 4066. Query whether the ATO is correct in rejecting this High Court case (which deals with s 51 rather than s 80E) as authority for s 80E regarding the “continuing business” requirement. It is to be noted that Barwick CJ and Mason J have adopted a broader view of the “same business” concept – for instance, changes in name, address and clientele are irrelevant.

³³ *Avondale Motors* 71 ATC 4101 at 4105; *Case U105* 87 ATC 637.

³⁴ TR 95/31 at paras 49 and 98.

³⁵ Williamson C and Bernhardt S, above n 7 at 18.

³⁶ *Avondale Motors (Parts) P/L v FCT* 71 ATC 4101 at 4104; *Northern Engineering P/L v FCT* 80 ATC 4025 per Brennan J at 4027, Deane J at 4028.

³⁷ *Avondale Motors (Parts) P/L v FCT* 71 ATC 4101. Author's emphasis.

³⁸ *Ibid* at 4106.

business" in its final ruling - namely, the business need not be "identical in every respect".³⁹

Consequently, a distinction is drawn between a "change in the identity of the business" and a "mere change in the process by which the business is carried on".⁴⁰ Here the termination of a major activity may be an example of the former, whereas mere expansion in scale exemplifies the latter.

How identical must the business be?

This is a question of degree. It demands due regard to what has changed and what remains the same.⁴¹ The non-exhaustive list of factors below are weighted differently, depending on the nature of a particular company's business and other circumstances of the case:⁴²

- product lines or income-producing services
- method of production
- market for product/service as defined by location, type of customers, etc
- name, goodwill and custom of the company
- sales - method, marketing/promotion, turnover, terms and conditions
- method/source of finance
- trademarks, patents and other intellectual property rights
- increase and decrease in the number of staff
- directors and management

These factors constitute and give identity to the overall business of a company. Accordingly, SBT is only satisfied where the business before and after the test time can be characterised as being the same, owing to the continuation of a sufficient number of these factors.⁴³ Therefore, it is important to keep records of these factors to demonstrate a company's compliance with s 165-210.⁴⁴

³⁹ TR 95/31 at para 34. This means that "absolute identity" is not required: *Case N109 81 ATC 620* at 622.

⁴⁰ TR 95/31 at paras 34 and 56. In other words, the issue is "whether the structure of the business has changed, as opposed to the matters of operational details which are part of the ongoing adoption of any business to commercial exigencies and changing market realities": *Case Y45 22 ATR 3395* at 3400.

⁴¹ TR 95/31 at para 55; Bernhardt S, "Continuity of business tests: a question of fact and degree" (1995) Issue 40 *CCH Tax Week* 746.

⁴² TR 95/31 at paras 56(g), 57 and 58. Note that significant weight is attached to the first four factors: paras 55 and 121.

⁴³ Williamson C and Bernhardt S, above n 7 at 19.

⁴⁴ Longes M, above n 5 at 277.

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After identifying the various changes, what is the permissible extent of these changes becomes the next question. The ATO allows organic growth from adopting “new compatible operations” and reductions in “the ordinary way”.⁴⁵ By contrast, a sudden or dramatic change such as acquisition by merger may fall foul of SBT.⁴⁶

While these descriptions may cause uncertainties in practice,⁴⁷ a simplified version is that evolution, expansion or contraction of business may not lead to change in identity unless it is of a considerable scale and/or it is sudden. Thus it would seem that a highly specialised company in a dynamic industry is likely to fail SBT.⁴⁸

Sources of identity: individual companies v group companies

Here the Commissioner has put forward two propositions:

- 1 A company’s business is identified by reference to its own activities and not those of other companies within the group.⁴⁹
- 2 However, changes in the business or identity of other companies in the group may result in corresponding changes for the taxpayer company.⁵⁰

The justification for the first proposition is that all companies are separate legal (and tax) entities which possess distinctive identities.⁵¹ Yet the second proposition seems to be unduly harsh and somewhat contradictory. If the identity of a business is to be ascertained solely from the taxpayer company, how can the activities of other companies change the identity of this particular taxpayer?

d) Meaning of “immediately”

SBT is not confined to the particular activities that are carried on immediately before the test time.⁵² This is consistent with the Commissioner’s “overall business” concept, in that the constituent activities of an overall business may be intermittent and temporarily suspended at the test time. However, the word “immediately” still imposes a temporal restriction on how far back the ATO can scrutinise a company’s activities.

⁴⁵ TR 95/31 at paras 10, 35 and 36.

⁴⁶ TR 95/31 at para 56(f).

⁴⁷ Bernhardt S, above n 46 at 746.

⁴⁸ Above n 1; Gates S and Miller H, “Same business test - carry forward of loss deductions” (1995) *Journal of Banking and Finance Law and Practice* 121.

⁴⁹ TR 95/31 at para 53.

⁵⁰ TR 95/31 at paras 53 and 56(1).

⁵¹ *Case N109 81 ATC* 620 at 624.

⁵² TR 95/31 at para 32.

Applying SBT to the scenario

R Co's overall business before the test time in March 1992 comprises the Japanese and the Italian restaurants. These dine-in services have been retained. R Co has also preserved its name, despite its ownership change. Thus the question is whether the additional elements have changed the identity of R Co's overall business:

- A new take-away service in the Japanese restaurant - this is likely to be considered as an "organic growth" (ie, additional method of sale) which merely results in change in scale rather than change in identity (or structural change of the business).
- A new Chinese restaurant - this may not be regarded as an expansion of the Japanese and the Italian restaurant business, for it introduces a different product line and a different market. Hence the "amalgamated business" after March 1992 is not the same as the previous business and fails SBT.⁵³

2 NEW BUSINESS TEST ("NBT"): S 165-210(2)(a)⁵⁴

Expressed as a negative requirement, NBT prohibits a company from obtaining income from a business in the same business test period which is different in kind from the activities carried on before the test time.⁵⁵

a) Meaning of "derives assessable income"

Income derivation is the operative part of NBT which represents the connection between the company and the relevant activity after the test time.⁵⁶ Hence there would be no breach of NBT if the company had not derived income from the relevant activity.⁵⁷ The word "income" in s 80E of the 1936 Act was equated to "assessable income" in TR 95/31.⁵⁸

⁵³ TR 95/31 at paras 67 and 110.

⁵⁴ This is originally called the "additional business" test in TR 94/D42: Shaw JD and Poke AR, "The continuity of business test" (February 1995) *National Accountant* 56.

⁵⁵ TR 95/31 at para 60 and 65; Boccabella D, "S 80E and the ATO's continuity of business draft ruling - time to focus on key matters" (1995) 26 *Weekly Tax Bulletins* 496.

⁵⁶ TR 95/31 at para 80; ATTA Conference Paper, above n 7 at 19.

⁵⁷ For example, *Case K1* 78 ATC 1.

⁵⁸ TR 95/31 at paras 15, 87 and 159.

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Clarification of "income"

The ATO has been praised for limiting NBT's scope in this respect, since the derivation of exempt income is not part of the mischief which CBT was intended to prevent.⁵⁹ Consequently, s 165-210(2) now explicitly refers to "assessable income". By adopting the ATO's view, s 162-210(2) has also rejected the interpretation which equates income with taxable income. However, the contention based on the purpose of s 165-210(2) as preventing "injection of income"⁶⁰ has its technical merits. It is arguable that where allowable deductions exceed the assessable income from a new business, no income injection (and thus no mischief) is taking place.⁶¹

"De minimis" exception⁶²

This is another positive feature of TR 95/31 - namely, the derivation of income which is "trifling", "insignificant" or "negligible" in amount will not cause companies to fail s 165-210(2) - an approach that is in line with judicial authorities.⁶³

b) Meaning of "business of a kind"

"Business"

While SBT refers to the overall business both before and after the test time, NBT nevertheless focuses on the individual undertakings or enterprises comprised in the overall business during the same business test period.⁶⁴ Such interpretation has been criticised for its:

- inconsistency - a word should be consistently interpreted in all parts of the section in which it appears;⁶⁵ and
- impracticality - determining what parts of the overall business should be treated as separate undertakings is not free from ambiguities.⁶⁶

On the other hand, those who regard the ATO's view as "correct" and

⁵⁹ TR 95/31 at para 87; ATTA Conference Paper, above n 7 at 20.

⁶⁰ TR 95/31 at paras 12, 23 and 63.

⁶¹ ATTA Conference Paper, above n 7; Williamson C and Bernhardt S, above n 7 at 20.

⁶² TR 95/31 at para 85.

⁶³ See, for example, *J Hammond Investments Pty Ltd v FCT* 77 ATC 4311 regarding rent receipt: Allerdice R, above n 2 at 14.

⁶⁴ TR 95/31 at para 64.

⁶⁵ ATTA Conference Paper, above n 7; Williamson C and Bernhardt S, above n 7 at 16.

⁶⁶ Bernhardt S, above n 41 at 747.

“sensible”⁶⁷ base their support on the context of NBT - in particular, its interaction with SBT. NBT would be superfluous if its content were equivalent or, very similar to, that of SBT. However, the later discussion will reveal the ATO’s failure to eliminate the overlap between SBT and NBT.

“Of a kind”

Despite the absence of the word “same” in NBT, the ATO has imported the identity requirement to NBT. Consequently, activities that are before and after the test time must be regarded as being of the same kind or “within the same field of endeavour”.⁶⁸ The ATO has been criticised for blurring NBT with SBT, since both tests require that the business be “same in kind” rather than “similar in kind”.⁶⁹ However, it is suggested that this identity requirement is not a source of overlap between the two tests, for the word “business” has different meanings.⁷⁰

The Commissioner also alludes to the point that the content of the word “kind” derives from the nature of business being carried on before the test time.⁷¹ It follows that the narrower the “kind” is specified, the more likely it is that the new activity will fall outside that kind.⁷²

Due to the different meanings of “business”, it is difficult to ascertain whether the ATO is comparing the new activity with the overall business or the particular activity within that overall business before the test time. The former seems preferable, because a new activity would not be regarded as “new” if it already existed prior to the test time.

c) Meaning of “before the test time”

Unlike s 165-210(1), the word “immediately” does not qualify the phrase “before the change” in s 165-210(2). Due to the absence of such a “temporal limit”,⁷³ one would expect that the investigation can go as far back as the company’s incorporation, and thereby enable the company to pass NBT, as it

⁶⁷ ATTA Conference Paper, above n 7 at 22; Abbey P, above n 1 at 937.

⁶⁸ TR 95/31 at para 68.

⁶⁹ TR 95/31 at para 100: Abbey P, above n 1 at 937.

⁷⁰ SBT requires that the overall businesses be of the same identity, whereas NBT requires the particular undertakings be of the same identity - thus the two tests impose the same identity requirement on different things. Here the overlap results not from the identity requirement, but from the notion of “descending hierarchy” that the overall business consists of various undertakings and transactions.

⁷¹ TR 95/31 at para 111.

⁷² ATTA Conference Paper, above n 7 at 22. For example, if the Japanese restaurant were to be classified as a “dine-in restaurant”, then a take-away restaurant would be of a different kind.

⁷³ Ibid at 9.

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would have experienced more kinds of activities.⁷⁴ However, the ATO has stated that the investigation must stop at “the point in the past where the business can no longer be described as the business carried on immediately before the test time.”⁷⁵ This means that only those activities which form part of the overall business being carried on immediately before the test time are relevant to s 165-210(2)(a).

The Commissioner’s approach is congruent with his view that the purpose of s 165-210(2) is to examine businesses and transactions which make up the overall business in s 165-210(1). Nevertheless, it does not explain why “immediately” has been omitted from s 165-210(2).

Applying NBT to the scenario

As previously mentioned, the additional Chinese restaurant may also result in failure of NBT. This is because R Co has derived income from this business which is different in kind from R Co’s Japanese and Italian restaurant business carried on before March 1992.

3 NEW TRANSACTION TEST (“NTT”): S 165-210(2)(b)

In spite of the expression used by the legislature, NTT can also be expressed in positive terms - namely, income derived from a transaction in the same business test period must be a transaction of a kind entered into before the test time.⁷⁶

Being combined with NBT in one section, the two tests share the elements of “assessable income”, “of a kind” and “before the test time” mentioned above.

a) Meaning of “entered into”

This phrase has a broad meaning such as to begin, join, engage, participate; to be concerned, involved and interested.⁷⁷ It serves as a connection between a transaction and the course of a company’s business operations.

b) Meaning of “business operations”

The ATO has given this phrase the same scope as the word “business” in SBT - “everything which a company undertakes or performs in the course of its business”.⁷⁸ With respect, equating “business operations” (plural) with

⁷⁴ Ibid at 22.

⁷⁵ TR 95/31 at para 84.

⁷⁶ Ibid.

⁷⁷ TR 95/31 at para 80.

⁷⁸ TR 95/31 at paras 14, 25 and 81.

“overall business” (singular) is likely to mislead, although it can be understood why the ATO has done so. If “business operations” were equivalent to activities that comprise the overall business (ie, the meaning of “business” in NBT), then it would be easier to satisfy NTT, for a transaction comprising the relevant activity is necessarily entered into in the course of that activity. Thus the ATO has imposed a further requirement that this activity also be related to the overall business, so that the transaction is within the course of the overall business.⁷⁹

c) Meaning of “transaction”

Again the meaning is wide and covers bilateral and unilateral dealings with property, as well as other means (whether or not passive in character) by which a company derives income.⁸⁰ Although it is relatively clear that NTT will be activated when an income-earning transaction entered into during the same business test period is outside the course of the business operations before the test time,⁸¹ it is nevertheless uncertain as to whether NTT extends to *daily or regular* transactions or whether it is only applicable to *isolated or independent* transactions. There are two competing views.

1 Sheppard J

[The NTT] is not intended to refer to the daily transactions involved in carrying on a business but to transactions of an isolated and independent kind, which transactions have nevertheless arisen in the course of the taxpayer’s business operations⁸²

This means that NTT is confined to transactions that are outside the ordinary course of “business” (ie, the meaning of business in NBT) but not outside the “business operations” (ie, the meaning of business in SBT). Here it can already be seen why such an approach is not favoured by the Commissioner, who insists upon the “transaction-enterprise-overall business” hierarchy.⁸³

⁷⁹ However, it is also possible that a transaction is within the course of the overall business, even though it may not be grouped into a particular enterprise – ie, the notion of “isolated and independent transaction”.

⁸⁰ TR 95/31 at paras 78, 79, 148 and 149 - but query whether this should extend to omissions - *Barron v Littman* [1953] AC 96 was cited by the ATO.

⁸¹ TR 95/31 at para 12; *J Hammond Investments Pty Ltd v FCT* 77 ATC 4311; *Fidler Downs* 79 ATC 4019.

⁸² *J Hammond Investments Pty Ltd*, above n 63 at 4318.

⁸³ That is, a transaction cannot be part of the overall business (ie, the meaning of “business” in SBT) without being part of the enterprises comprising the overall business (ie, the meaning of “business” in NBT). This is because the “overall business” consists of various “enterprises” which consists of individual “transactions”.

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However, Sheppard J's approach has earned academic support⁸⁴ due to, inter alia, its consistency with the example given in the Explanatory Memorandum to the Income Tax Assessment Bill 1965.⁸⁵

2 *Campbell J*

[The NTT] contemplates that the transaction not previously carried on was one which could have been carried on in the course of the company's business operations prior to the change.⁸⁶

This has been interpreted and adopted by TR 95/31.

- NTT examines all transactions, whether they are regular or isolated transactions.⁸⁷
- However, NTT will not be failed where the transaction could have been entered into ordinarily and naturally in the course of business operations before the test time.⁸⁸ This notion of potential transactions⁸⁹ is indicative of the ATO's relaxation of NTT since its draft ruling.⁹⁰

Nevertheless, NTT is still regarded as a stringent test, since a wide range of transactions will have to be examined in order to find the requisite identity. Moreover, it has been argued that Campbell J's approach should be rejected for the following reasons:

⁸⁴ For example, Allerdice R, above n 2 and Boccabella D, above n 55.

⁸⁵ Explanatory Memorandum to Income Tax Assessment Bill 1965, extracted in Allerdice R, above n 2 at 24. Indeed, an arrangement where a takeover company pays a service fee to a loss company to enable utilisation of loss is not normally in the ordinary course of the company's business.

⁸⁶ *Fielder Downs* above n 63 at 4025.

⁸⁷ TR 95/31 at para 76.

⁸⁸ TR 95/31 at paras 12, 145 and 165. Conversely, an extraordinary or unnatural transaction judged by the course of business operations will fail NTT – eg, “non-arm's length transaction at grossly artificial prices”.

⁸⁹ This can be inferred from the phrase “transactions which could have been entered into”. It means that a company will not fail NTT if its new transaction is one that could have been entered into in the course of its business operations before the test time. Here the comparison is between the new transaction and the actual, as well as the potential, transactions before the test time.

⁹⁰ Bryant R, above n 16 at 93; Challoner NE, “Continuing business test - s 80E Income Tax Assessment Act” (October 1977) *The Chartered Accountant in Australia* 34; Allerdice R, above n 2 at 14.

But contrast the interpretation in Miller H, “Same business test - carry forward of loss deductions” (1995) *Journal of Banking and Finance Law and Practice* 121 at 122 - company still fails NTT even where transactions can be characterised as one ordinarily involved in its business operations. If this interpretation were correct, then Campbell J's formula would have created an extremely stringent NTT, for the comparison would be between the new transaction and only the transactions actually entered into before the test time.

- NBT is rendered otiose by the more specific NTT, especially in its role as restricting the kind of activities;⁹¹ and
- the scrutiny of transactions that are significant both in scale and diversity is impractical and gives rise to unacceptable administrative costs.⁹²

Applying NTT to the scenario

Here the lease agreement between R Co and the owner of the ice-cream parlour is the relevant “new transaction”. Such a transaction, being of an isolated and independent kind,⁹³ can nevertheless arise in R Co’s overall business as a restaurateur.⁹⁴ Consequently, the lease agreement is within the ambit of NTT on both views.

- *Has assessable income been derived?*
Depending on the terms of the lease agreement, the relevant income may be a deposit (key money) and/or rental. If the first rent instalment was not due and payable until a future date, then the deposit alone would constitute assessable income. However it may fall within the de minimis exception, depending on its exact amount.
- *Does the transaction satisfy NTT?*
Assuming that the de minimis exception cannot be invoked then, applying the Commissioner’s approach, the lease agreement could have been entered ordinarily and naturally in the course of R Co’s business operations before March 1992.

4 ANTI-AVOIDANCE TEST: S 165-210(3)

Common elements with s 165-210(2)⁹⁵

“Business” is given the same meaning as in NBT. Again the meaning of “business operations” is equivalent to that of “overall business”. “Transaction of a kind” also mirrors the meaning given in NTT. In the absence of any reported decisions on this test, these interpretations are at least internally consistent throughout the Ruling. However, one may still wonder why the

⁹¹ *J Hammond Investments Pty Ltd*, above n 63 at 4318; ATTA Conference Paper, above n 7 at 24; Boccabella D, above n 55.

⁹² ATTA Conference Paper, above n 7 at 25.

⁹³ This is because it is not part of R Co’s dining services.

⁹⁴ For example, making better use of the restaurant by leasing out an unused portion of its premises for the purpose of complementing and enhancing its business. (Italian food plus ice-cream may be an appealing combination!)

⁹⁵ TR 95/31 at para s 16, and 91-93.

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word “business” is used by the legislature instead of “business of a kind”, particularly when “transaction of a kind” is used.

Purpose element

The Commissioner’s view that the tainted purpose (ie, tax avoidance purpose) need not be the sole purpose is in conformity with the express words of s 165-210(3).⁹⁶ Yet the remaining question is whether the phrase “purposes that included the purpose” also suggests that the tainted purpose need not be dominant.⁹⁷

5 THE NEW EXPENDITURE TEST: S 165-210(4)

Subsection (4) introduces a new disqualifier which means that a company can also fail NBT and NTT if it incurs expenditure as a result of its new businesses or transactions. It increases the stringency of s 165-210 by expanding the scope of NBT and NTT - a change that is apparently unfavourable to taxpayers. Yet, many seem to overlook the significance of this disqualifier. This may be because the unknown rationale, scope and content of s 165-210(4) simply make it too early and too difficult to articulate any implications.

Purpose of s 165-210(4)

The new expenditure test may have been introduced for two reasons. First, it is there to cover the loophole in the old NBT and NTT, since the trigger of income derivation provided an incentive to commence businesses where returns are deferred. Here the compromising inclusion of “assessable income” in the new NBT and NTT has been balanced against the addition of this new disqualifier. Second, it is there to standardise all the continuity of business tests under the 1936 Act - the “expenditure test” is in fact an existing limb of the same business test in relation to “eligible notional loss” for current year losses.⁹⁸

Meaning of “expenditure”

Section 165-210(4) is almost identical to s 165-210(2), apart from its distinguishing (and operative) phrase “incurs expenditure”. Accordingly, the meaning of this test depends upon the following open questions.

⁹⁶ TR 95/31 at para 9.

⁹⁷ Academic support of this view can be found in “TR 95/31: Continuity of business test” (1995) 40 *Weekly Tax Bulletins* 819.

⁹⁸ 1936 Act, see s 50D(4)(b).

- a) When does a company “incur” expenditure for the purposes of s 165-210(4)?
- b) What does “expenditure” mean? Under the 1936 Act, expenditure is broadly defined to include losses and outgoings.⁹⁹ However, capital expenditure is excluded in certain circumstances.¹⁰⁰ Hence a relevant question may be: does the common law income-capital distinction also apply to the meaning of expenditure?
- c) Does the de minimis exception apply to both income and expenditure? It is arguable that the incurrence of expenditure which is negligible in amount should not cause a company to fail s 165-210(4), just as a company will not fail s 165-210(2) by deriving a minimal amount of income. Consistency and fairness would suggest that the de minimis exception should be available to 165-210(4).¹⁰¹

CRITIQUE OF TR 95/31

Prior to identifying the difficulties that stem from the Ruling, it is convenient to summarise some of the Ruling’s positive features:

- the relaxation of SBT by removing the “absolute identity” requirement from TR 94/D42;¹⁰²
- the exclusion of exempt income from NBT and NTT;¹⁰³
- the de minimis exception to the income in NBT and NTT;¹⁰⁴
- the relaxation of NTT by recognising the “potential transactions” approach - TR 94/D42 treated any new transaction as capable of failing the test.¹⁰⁵

⁹⁹ 1936 Act, see ss 51AK(5) and 136AA.

¹⁰⁰ 1936 Act, see, eg, ss 51AGB and 89JC.

¹⁰¹ If the meaning of “expenditure” were intended to be wide, then s 165-210(4) would deprive companies of their innovative but genuine attempts to improve their businesses. For instance, R Co in the case study would fail this test by incurring expenditure from adding the take-away service to its Japanese restaurant and from leasing part of its Italian restaurant. Thus a de minimis exception could at least alleviate the harshness of such restraint.

¹⁰² “Continuity of business test: TR 95/31” (1995) Issue 38 *CCH Tax Week* 714 at 717; Bernhardt S, above n 46 at 746; Coadys R, “TR 95/31: company losses - continuity of business test” (28-29 September 1995) Taxation Institute of Australia Convention Papers 99.

¹⁰³ Moschner M, “Draft ruling corrected” (1995) 30 *Taxation in Australia* 260 at 261.

¹⁰⁴ Allerdice R, above n 2 at 14.

¹⁰⁵ Bryant R, above n 16 at 93; Challoner NE, above n 90.

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However, TR 95/31's retrospective application¹⁰⁶ has attracted popular criticism. For instance, the potential economic impact may lead to unfairness.¹⁰⁷ The problems or inadequacies of TR 95/31 will now be discussed.

A Policy issues - purpose and function of the continuity of business test

From 1944 to 1965, companies that failed the continuity of ownership test forfeited their losses.¹⁰⁸ The approach to the continuity of ownership test (s 80A) and the later introduction of the continuity of business test (s 80E) in 1965¹⁰⁹ seem to send "mixed signals".¹¹⁰ As a result, there were two competing (but not necessarily incompatible)¹¹¹ views on the underlying policy of s 80E.

1) Section 80E as an anti-avoidance/deduction denial section¹¹²

This suggests that s 80E is directed at the mischief of loss trafficking.¹¹³ Such an interpretation would justify a strict approach to s 80E. In this regard, s 80A and s 80E share the same function of prohibiting loss transfers, however they attack the mischief from different perspectives. Section 80A looks to the shareholders by piercing the corporate veil,¹¹⁴ whereas s 80E focuses purely on activities carried on by companies.¹¹⁵ Therefore, the company's business, rather than the company itself, is the tax entity for the purpose of s 80E. By contrast, s 80A regards company shareholders as the relevant taxpayer.

¹⁰⁶ That is, before and after its date issue on 30/8/95: Para 17; Bryant R, "Review of current developments involving tax losses" (28-29 September 1995), Tax Institute of Australia Convention Papers 92 at 94.

¹⁰⁷ Bernhardt S, above n 46 at 748.

¹⁰⁸ Allerdice R, above n 2 at 10.

¹⁰⁹ Section 80E was inserted into the ITAA by Act No 103 of 1965. It was later amended by Act No 51 of 1973: *J Hammond Investments Pty Ltd*, above n 63 at 4317.

¹¹⁰ ATTA Conference Paper, above n 7 at 3.

¹¹¹ See *Case Y45 22 ATR 3395*: s 80E is "part of an anti-avoidance scheme designed to prevent trafficking in loss companies" (at 3396) but it is also "a saving provision" that operates only if the company fails s 80A (at 3400).

¹¹² For example, *Avondale Motors* 71 ATC 4101 at 4106; *Case Y45 22 ATR 3395* at 3396.

¹¹³ Bryant R, above n 16; Allerdice R, above n 2 at 14.

¹¹⁴ Allerdice R, *ibid* at 10.

¹¹⁵ ATTA Conference Paper, above n 7 at 8.

2) *Section 80E as a saving/deduction restoration section*¹¹⁶

This regards s 80E as the exception to the general rule in s 80A (which is the relevant deduction denial section in this context).¹¹⁷ Furthermore, s 80E can also be viewed as an “entitlement provision”, as it provides companies with a government subsidy in the form of a tax break on future profits.¹¹⁸

Since s 80E is seen to be preventing drastic consequences that would otherwise arise from failing s 80A, one may expect that the approach to s 80E would be relatively lenient. However, the contrary view has been expressed by the Administrative Appeals Tribunal¹¹⁹ - namely, it is appropriate to read a saving provision reasonably strictly.

In light of the limited judicial statements on s 80E’s operative policy (due to the absence of borderline cases),¹²⁰ all that can be said is that s 80E operates only when a company fails to pass s 80A.¹²¹ The question is whether s 80E can also be utilised by a company which does not satisfy the additional continuity of ownership tests in s 80DA.

3) *What is the nature of s 165-210?*

The new continuity of business tests are expressed as alternative, safeguarding tests for loss companies which fail to satisfy the continuity of ownership test. Yet the addition of the new expenditure test suggests that s 165-210 is in substance a deduction denial section.

While the rewrite has failed to articulate the policy of the continuity of business tests, it has nevertheless clarified the following two questions which were unsatisfactorily addressed in TR 95/31.

a) *Interaction with s 80DA*

Section 80DA contains four additional continuity of ownership tests. One of them disallows prior year losses where the benefits from the loss deduction would be enjoyed by those who were not the shareholders in the year in which the losses were incurred.¹²² Here the question is whether s 80E can still save a company that has failed the additional tests in s 80DA.

¹¹⁶ For example, *Case Y45 22 ATR* 3395 at 3410.

¹¹⁷ TR 95/31 at para 12; ATTA Conference Paper, above n 7.

¹¹⁸ Ibid.

¹¹⁹ *Case Y45 22 ATR* 3395 at 3400.

¹²⁰ ATTA Conference Paper, above n 7.

¹²¹ Australian Tax Practice, *Australian Tax Handbook* (1997), Australian Tax Practice, Sydney.

¹²² Section 80DA(1)(d) of the 1936 Act; s 165-15(1) of the 1997 Act.

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Both s 80A and s 80DA are subject to s 80E, while s 80A is also subject to s 80DA.¹²³ As such, s 80A and s 80DA may be appropriately classified as the deduction denial provisions, and s 80E may be classified as the deduction restoration provision.

The Commissioner's conflicting answers are, to some extent, a consequence of the contradictory wording in s 80E. The pre-condition to the operation of s 80E is that there must be a disqualifying change in beneficial ownership of shares.¹²⁴ The Commissioner has interpreted this to mean that s 80E only applies where breach of s 80DA is attributable to ownership change (ie, failure of s 80A).¹²⁵

Contrarily, the concluding sentence in s 80E(1) states that "s 80A and s 80DA do not prevent the whole of the loss being so taken into account". This has been acknowledged twice in the Ruling.¹²⁶ Thus it seems that compliance with s 80E will negate operation of s 80DA in all circumstances¹²⁷ - a view which is now confirmed by the 1997 Act.

Despite the rearrangement of the s 80DA tests into the new divisions 165 and 175,¹²⁸ it is now clear that continuity of business tests are available to loss companies which are unable to comply with the continuity of ownership test, income injection test and tax benefit test, etc.¹²⁹ Such clarification amounts to an implication that the continuity of business tests perform the function of restoring (as opposed to denying) loss deductions.

b) *Tax avoidance purpose*

A review of cases on the continuity of business tests reveals that the relevant taxpayers in most (if not all) of the cases possessed tax avoidance motives. Moreover, s 80E(1) contains SBT, NBT and NTT, while the anti-avoidance

¹²³ Section 80A(1) and s 80DA(1) of the 1936 Act.

¹²⁴ Section 80E(1)(a) of the 1936 Act.

¹²⁵ TR 95/31 at para 3.

¹²⁶ TR 95/31 at paras 4 and 8.

¹²⁷ ATTA Conference Paper, above n 7 at 5; Challoner NE, above n 90; Bryant R, above n 16.

¹²⁸ Conversion Table:

1936 Act	1997 Act
s 80DA(1)(a)	s 175-10(1) income injection test
s 80DA(1)(b)	s 175-15(1) tax benefit test
s 80DA(1)(c)	omitted
s 80DA(1)(d)	s 165-15(1)

¹²⁹ Sections 165-15(2) and 17505(2) of the 1997 Act; Explanatory Memorandum to the Income Tax Assessment Bill 1996 and associated Bills, CCH reporter, at paras 22, 234 and 22, 238.

s 80E(2) is expressed as an exception to s 80E(1). Two inquiries emerge from these observations.

- 1 Are the tests in s 80E(1) purposive? In other words, does the operation of s 80E(1) depend upon the presence of a tax avoidance purpose?
- 2 If not, does s 80E(1) nevertheless import a purpose test into its application?

With respect to the first question, a positive answer can be implied from the Treasurer's Second Reading Speech in 1964, as well as the Explanatory Memorandum accompanying the 1964 Bill.¹³⁰ However, this is difficult to reconcile with the structure of s 80E. Subsection (1) consists of three tests without mentioning purpose on its face, whereas subsection (2) is a purpose test cast as an exception to subsection (1). The argument and the counter-argument may be as follows.

- Section 80E(1) and (2) are to be read separately - the former is subject to the latter, meaning that its application may be denied by the anti-avoidance subsection. Thus (2) would be redundant if (1) were purposive.
- Section 80E(1) and (2) are to be read as a whole - thus s 80E contains four disqualifiers - SBT, NBT, NTT and tax-avoidance purpose.

The second question may be phrased as whether purpose can be a surrogate for the identity requirement in s 80E(1). The High Court has fortified a purpose approach in *Avondale Motors*.¹³¹ However, it should be noted that the taxpayer in that case conceded that his sole purpose was to benefit from tax losses.

¹³⁰ Allerdice R, above n 2 at 11.

Mr Holt's (the then Treasurer) Second Reading Speech:

The government considers that this amendment will satisfactorily meet the cases of mergers and takeovers of companies that are carried out for sound economic purposes and with which there is not associated any transfer of profitable businesses from one company to another so that income which would otherwise be taxed is derived free of tax.

Explanatory Memorandum accompanying the 1964 Bill:

The paragraphs are designed to deny such a deduction in such circumstances as where the loss company and a company that takes it over enter into transactions which have, as their purpose or effect, the transfer of income from the takeover company to the loss company.

¹³¹ 71 ATC 4101 at 4106: "[The purpose of s 80E is] to prevent persons from profiting by acquisition of control of a company for the sole purpose of claiming its accrued losses as a tax deduction."

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Here the Commissioner's answer is ambiguous, as exemplified by its application of s 80E(1)(c). Paragraph 12 says that "transactions which are usually unmotivated by tax avoidance" will not fail NTT. Yet paragraph 63 states that "the NBT and NTT do not depend for their operation on the existence of a purpose of tax avoidance".

On balance it seems that, although the presence of a tax avoidance purpose is not a pre-condition to applying s 80E(1), it is nevertheless a weighty factor in determining whether s 80E(1) can be satisfied. By contrast, the anti-avoidance subsection in the new s 165-210 is expressed as a separate test in addition to other continuity of business tests. This reinforces the view that SBT, NBT and NTT are not purpose tests.

B Technical issues¹³² - overlap between s 165-210(1) and (2)

Truly a "descending hierarchy"?

There is no judicial authority on the complete application of the continuity of business tests. Most cases failed on the first requirement of SBT.

TR 95/31 will be evaluated in the context of the new s 165-210 rather than the old s 80E. The flaws in the ATO's interpretation in this respect will directly affect s 165-210 to the extent that s 165-210 adopts the terminology of s 80E.

Revisiting the structure of s 165-210

In the Commissioner's opinion, the "three cumulative requirements"¹³³ form a "descending hierarchy":¹³⁴

- 1 *SBT* tests "the business of the company as an entirety" (ie, overall business);
- 2 *NBT* tests "the undertakings/enterprises of that business";
- 3 *NTT* tests "the individual transactions/acts by which the business is carried on".

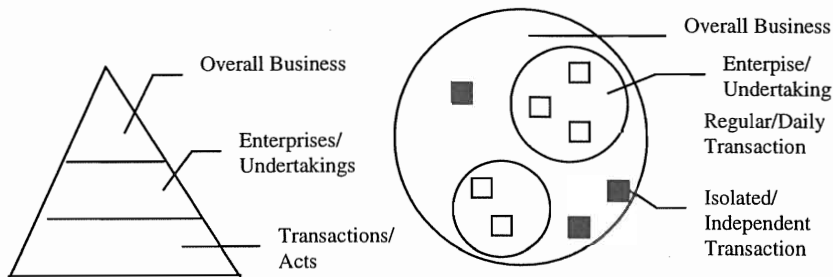
¹³² Criticisms of the following issues have been already been dealt with:

- SBT - multiple businesses being treated as single business
- different meanings of "business" in SBT and NBT - a source of confusion?
- meaning of "transaction" - NTT rendered indistinguishable from NBT?

¹³³ *Fielder Downs*, above n 63 at 4023.

¹³⁴ TR 95/31 at paras 20 and 78.

These can be represented by the two diagrams below. It is suggested that although the triangular structure illustrates the notion of “hierarchy”, the circular structure nevertheless reflects the ATO’s approach more closely.



Here, it can be seen that a company’s “overall business” is composed of various “enterprises” and “transactions” - that is, “the business-enterprise-transaction hierarchy”. The difficulty lies in categorising an activity into one of these terms.

Searching for identity - the characterisation process

The circular structure above also clarifies the Commissioner’s approach to the continuity of business tests:

- 1 SBT - in characterising the *business* (ie, overall business), regard must be had to the enterprises comprising the business as a whole.
- 2 NBT - in characterising an *enterprise*, regard must be had to the transactions comprising the enterprise as a whole.
- 3 NTT - in characterising a *transaction*, regard must be had to the scope of the overall business.¹³⁵

Descending in generality/scope?

The tests become narrower and more focused as the list goes down - starting with an examination of the overall picture in s 165-210(1), then descending to closer examination of its particular components in s 165-210(2). An immediate conclusion would be that the satisfaction of the more specific s 165-210(2) entails the satisfaction of s 165-210(1). Yet the converse

¹³⁵ That is, the new transaction must be within the overall business (in the course of business operations) but need not be grouped into a particular enterprise.

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proposition does not apply. This is supported by the fact that the scope of s 165-210(1) covers that of s 165-210(2).

However, such a conclusion is at odds with the following:

- courts have suggested that satisfaction of s 165-210(1) increases the likelihood of passing s 165-210(2);¹³⁶ and
- the examples in TR 95/31 demonstrate the perplexing possibilities of passing NBT but failing SBT, as well as passing both SBT and NTT but failing NBT.¹³⁷

While appearing absurd at first glance, these outcomes are not inexplicable.

Reconciling s 165-210(1) with s 165-210(2)

Academic criticism is directed at the ATO's treatment of situations where a new undertaking is acquired and amalgamated with a company's overall business. Here, the Commissioner's approach can be summarised as follows:¹³⁸

Apply SBT - if satisfied, then

Apply NBT - two steps:

- a) determine whether the new undertaking is "business of a kind" prior to the test time; and
- b) if yes, determine whether the "amalgamated business" (ie, the new overall business) is the same as the overall business prior to the test time.¹³⁹

The second step has encountered rigorous attack. First, it is circuitous and illogical to re-apply SBT once that test is satisfied.¹⁴⁰ Second, NBT is

¹³⁶ For example, *Avondale Motors* 71 ATC 4101 at 4104; *J Hammond Investments Pty Ltd*, above n 63 at 4316. This comment is inevitable if courts were to regard s 165-210(1)(2) as imposing three cumulative requirements. Thus s, 165-210(1) must be satisfied before applying s 165-210(2). However, this comment can also be construed as implicitly suggesting that s 165-210(2) is less stringent than (or at least as stringent as) s 165-210(1).

¹³⁷ TR 95/31 at paras 67, 113 and 143.

¹³⁸ TR 95/31 at paras 66 and 67.

¹³⁹ That is, whether the addition of the new undertaking changes the identity of the previous overall business. Applying these two steps to the Chinese restaurant in the case study:

- 1) whether the Chinese restaurant business and the "Japanese plus Italian restaurant business" are of the same kind;
- 2) whether the "Japanese plus Italian plus Chinese restaurant business" and "Japanese plus Italian restaurant business" are of the same kind.

¹⁴⁰ *Abbey P*, above n 1 at 937; *Bryant R*, above n 16 at 93.

rendered redundant and deprived of any practical application as it is subsumed into SBT.¹⁴¹

The ideology that SBT and NBT “cover the field”¹⁴² by embodying the positive side and the negative side of the test respectively is not a compelling defence. However, an attempt has been made to find a solution:

1 *The “Circularity” criticism*

Here the Commissioner’s defect may be remedied by reversing the order of tests – ie, apply NBT and then SBT. This seems to be contrary to the notion of “cumulative requirements” and the structure of s 165-210. Although it is appropriate for the legislature to prescribe requirements in a “descending hierarchy”, it is convenient and practical to apply the prescribed requirements in the reverse order.¹⁴³

2 *The “Redundancy” criticism*

As the overall business is comprised of undertakings and transactions, the scope of s 165-210(1) covers s 165-210(2). However, double scrutiny of these undertakings and transactions can be avoided by focusing on the comparison between distinct activities and on income derivation.

a) *Old activities v new activities*¹⁴⁴

SBT compares the activities that have been retained after the test time with the existing activities before the test time.¹⁴⁵ NBT and NTT, on the other hand, compare the distinctive new activities after the test time with the original activities before the test time.¹⁴⁶

This approach is favourable because of its simplicity and conformity with the names “new business” and “new transaction” tests. In

¹⁴¹ Furthermore, in light of the ATO’s interpretations of “transaction” and “business operations”, it is equally arguable that NTT is also being subsumed under SBT.

¹⁴² Allerdice R, “Review of current developments in tax losses” (1996) *Tax Institute of Australia* 9 at 13.

¹⁴³ This is also supported by the ordinary principle of statutory interpretation that the more specific section applies where more than one provision is potentially applicable.

¹⁴⁴ Allerdice R, “Review of current developments in tax losses” (1996) *Tax Institute of Australia* 9 at 12.

¹⁴⁵ Looking at the hypothetical scenario, SBT seems to be satisfied as both the original businesses of Japanese and Italian restaurants are retained after the test time. Here, the test is applied without regard to the Chinese restaurant.

¹⁴⁶ Here, the additional Chinese restaurant is compared with the original Japanese and Italian restaurants to see whether they are of the same kind.

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addition, it is supported by Gibbs J's example in *Avondale Motors*.¹⁴⁷ However, the exclusion of new activities from the process of characterising the new overall business after the test time is inconsistent with the characterisation process of the previous overall business prior to the test time.¹⁴⁸

b) Income derivation

As previously mentioned, the phrase "derives assessable income" is an important distinguishing feature of s 165-210(2). Here the scope of s 165-210(2) is restricted to activities that have derived income, whereas s 165-210(1) examines all activities, whether or not income has been derived.

Although this observation does not remove the overlap between subsections (1) and (2), it nevertheless explains why a company may pass subsection (1) and yet fail subsection (2). For instance, a new activity that has not derived income does not fall foul of subsection (2), but such an activity may be so significant that it changes the identity of the overall business and therefore fails subsection (1). Again, the convenience in applying s 165-210(2) before s 165-210(1) is manifest.

CRITIQUE OF THE REWRITE: CAN S 165-210 PERFECT AN IMPERFECT S 80E?

Section 80E: problems and weaknesses

Section 80E has been reproved for being "a most imperfect section" that generates numerous interpretational difficulties.¹⁴⁹ There are several causes of its contentious administration.

- a) The absence of an apparent policy:¹⁵⁰ It is unclear as to whether s 80E supplements s 80A in combating loss trafficking, or whether s 80E is intended as a recourse for companies that do not satisfy s 80A. The

¹⁴⁷ 71 ATC 4101 at 4104: before the test time a company carried on the business of motor dealer; after the change, that comp. ... continued to carry on the same business, but carried on in addition a grocery business.

¹⁴⁸ In the latter, the identity is ascertained from all activities carried on before the test time. Thus the identity of the new overall business should also be ascertained from all activities carried on after the test time.

¹⁴⁹ Allerdice R, above n 2 at 14-15; ATTA Conference Paper, above n 7 at 1; Boccabella D, above n 55.

¹⁵⁰ ATTA Conference Paper, above n 7 at 1.

mere statement that s 80E is an alternative to s 80A does not explain the operative policy of s 80E.

- b) The misleading concealment of its objective operation:¹⁵¹ It has been observed that “the weapons which have ostensibly been introduced to counter tax loss trafficking apply irrespective of whether or not loss trafficking or other elements of tax avoidance are present”.¹⁵² Indeed, taxpayers should be informed that genuine commercial activities may still fall foul of s 80E.
- c) Failure to achieve anti-tax avoidance (if this is its purpose): Genuine commercial activities may be “unlucky to be caught in a net that was put out to catch other types of fish”.¹⁵³ It is often argued that a general anti-avoidance section (eg, Pt IVA of the 1936 Act) would be a better mechanism.¹⁵⁴
- d) Conflicting references to s 80DA: As discussed earlier, it is not completely settled as to whether s 80E is available only when s 80A is not satisfied.
- e) Remoteness from commercial reality:¹⁵⁵ Section 80E effectively condemns loss companies to carry on the very same business which led to their losses in the first place. Further, it deters and penalises creative but genuine attempts to improve a business.

Section 165-210: structural and substantive changes

The reworded and restructured provisions in s 165-210 do not materially differ from those of s 80E.¹⁵⁶ However, several areas of ambiguity have been clarified.

- a) By establishing the primacy and applicability of s 165-210 through other provisions in the 1997 Act, it is now certain that companies can rely on the continuity of business tests if they are unable to meet the tests contained in s 80A and s 80DA of the 1936 Act.

¹⁵¹ Allerdice R, above n 2: “It does not advance the interests of a democratic society for measures to be represented as being designed to stop loss trafficking when their operation is far beyond loss trafficking.”

¹⁵² Ibid.

¹⁵³ *Case K20* 78 ATC 184 at 187: This illustrates “the inability of a so-called loss trafficking test to bring about outcomes which resemble the outcome from an accurate application of the section and which gives effect to the policy of s 80E.” (ATTA Conference Paper, above 7 at 10).

¹⁵⁴ Challoner NE, above n 90.

¹⁵⁵ Woellner, Vella, Burns and Barkoczy, *1996 Australian Taxation Law* (6th edn 1996 CCH Australia Ltd) at 1076; Allerdice R, above n 2 at 14-15. See ATTA Conference Paper, above 7 at 7 and 11 for opposing views regarding public interests in preserving employment, minimising disruption to creditors and maintaining stability, etc.

¹⁵⁶ Slater T, “Valuable gains from your losses” (1996-97) 2 *Taxation Institute of Australia Convention Papers* 478 at 484.

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- b) By arranging NBT and NTT in two subsections, the distinctiveness and the independence of these two tests are manifest.
- c) By stipulating the anti-avoidance subsection as a separate disqualifier, there is a strong indication that a tax avoidance purpose is not an element in other continuity of business tests.
- d) By stating that "assessable income" is the trigger of NBT and NTT, s 165-210 has removed the controversy regarding the interpretation of "income" in s 80E.

In spite of the above positive features, s 165-210 is not immune from criticisms. It remains a highly contentious provision because of its retention of certain contentious words, as well as its additional elements.

1 *Existing controversies*

Section 165-210 is named the "SBT" in which NBT and NTT are expressed as the elements or conditions of SBT. This has the potential of eliminating the ATO's problematic and inflexible "business-enterprise-transaction" descending hierarchy. Unfortunately, the retention of contentious phrases such as "business of a kind", "transaction of a kind", "business operations" and "immediately before" means that the following problems remain unresolved:

- the treatment of multiple businesses as one business;
- the circuitous and duplicate application of SBT when applying NBT (ie, overlap between SBT and NBT);
- different meanings are given to the word "business" without sufficient clarity;
- the extent to which past activities can be taken into account; and
- the debatable interpretation of "transaction" (ie, overlap between NBT and NTT).

Critics contend that the Tax Law Improvement Project rewrite has not achieved the real simplification of the tax law, for the style and policy of the old provisions often remain unaltered.¹⁵⁷

2 *New controversies*

Section 165-210 uses "same business test period" and "test time" to replace "the year of income" and "the change" respectively. Yet the definitions in s 995-1 lack clarity. They tend to vary in accordance with their statutory context. On the other hand, the new expenditure test may render s 165-210 even more contentious. Not only is it necessary to articulate its rationale and content, the desirability and justifiability of such a disqualifier is debatable.

¹⁵⁷ Lehmann M, above n 8 at 517-518; (1997) 20 *Australian Tax Weekly* para 283.

CONCLUSION: A PROPOSED CBT?

In the absence of any judicial evaluation on TR 95/31, re-writing the continuity of business tests is indeed a daunting task. An attempt has been made to outline the steps in applying s 165-210. It is hoped that these steps can aid in overcoming the difficulties concerning the inter-relationship between the various disqualifiers. While the underlying concern is what test does the company fail to satisfy, in practice the failure of any test results in the failure of s 165-210.¹⁵⁸ I set out below guidelines as to how a CBT might apply.

Guidelines on applying CBT

Step 1

Identify all activities carried on before the test time (ie, ownership change):¹⁵⁹

- a) the SBT is failed upon the cessation of all activities before the test time; and
- b) the anti-avoidance test is failed upon the addition of new activities to existing activities for tax-avoidance purposes (eg, loss trafficking).¹⁶⁰

Step 2

Identify all activities carried on in the recoupment year.

Step 3

Compare 1 and 2: is the identity of the overall business maintained? (SBT)

- a) Are there new activities in 2?¹⁶¹ If yes, then:
 - has assessable income been derived, or has expenditure been incurred from these activities? or

¹⁵⁸ A company does not satisfy s 165-210 if:

- a) it does not carry on the same business as it did before the test time, or
- b) it derives assessable income from a new business or transaction, or
- c) it incurs expenditure from a new business or transaction, or
- d) it commences a new business or transaction in order to satisfy the above tests.

¹⁵⁹ For example, the provision of dining services in two restaurants, featuring Japanese and Italian food.

¹⁶⁰ An example may be that Chinese dishes were added to the menu of the Japanese restaurant before the test time in March 1992.

¹⁶¹ The new Chinese restaurant and the lease agreement - see previous conclusions from applying NBT and NTT.

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- are these activities of a kind in 1? (If no, then there is a failure of either NBT or NTT).¹⁶²
- b) Are the activities in 1 retained? (SBT)
 - If yes, what is the type and extent of changes to them?¹⁶³ (eg, an expansion or reduction in scope).
 - If no, what is the type and number of the discarded activities?

¹⁶² It is difficult to identify what is a “transaction” and what is an “enterprise” or “undertaking”. However, it is relatively clear from this approach that, where one of more specific tests (ie, NBT and NTT) in s 80E(1)(c) is failed, then SBT need not be applied.

¹⁶³ The additional take-away service - see the relevant part of the previous application of SBT.

APPENDIX

Section 80E: Losses of previous years may be taken into account where company carries on the same business

80E(1) [Continuity of business test] Subject to sub-section (2), where -

- (a) the whole or part of a loss incurred by a taxpayer, being a company, in a year before the year of income would not, but for this section, by reason of a change that has taken place in the beneficial ownership of shares in the company or in any other company, be taken into account for the purposes of section 79E, 79F, 80, 80AAA or 80AA;
- (b) the first-mentioned company carried on at all times during the year of income the same business as it carried on immediately before the change referred to in paragraph (a) took place; and
- (c) the first-mentioned company did not, at any time during the year of income, derive income from a business of a kind that it did not carry on or from a transaction of a kind that it had not entered into the course of its business operations, before the change took place, sections 80A and 80DA do not prevent the whole of the loss being so taken into account.

80E(2) [Attempt to circumvent subsection (1)]

Sub-section (1) does not apply in respect of a loss incurred by a taxpayer being a company in a year before the year of income if -

- (a) before the change took place, the company commenced to carry on a business that it had not previously carried on or entered into, in the course of its business operations, a transaction of a kind that it had not previously entered into; and
- (b) the company commenced to carry on that business or entered into that transaction for the purpose, or for purposes that included the purpose, of enabling the company to take into account, by virtue of sub-section (1), for the purposes of section 79E, 79F, 80, 80AAA or 80AA a loss that the company had incurred in a year before the first-mentioned year or might incur in the first-mentioned year.

Subdivision 165-E: The same business test

SECTION 165-210: THE TEST

- (1) The company satisfies the *same business test* if throughout the same business test period it carries on the same business as it carried on immediately before the test time.

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- (2) However, the company does *not* satisfy the same business test if, at any time during the same business test period, it derives assessable income from:
 - (a) a business of a kind that it did not carry on before the test time; or
 - (b) a transaction of a kind that it had not entered into in the course of its business operations before the test time.
- (3) The company also does *not* satisfy the same business test if, before the test time, it:
 - (a) started to carry on a business it had not previously carried on; or
 - (b) in the course of its business operations, entered into a transaction of a kind that it had not previously entered into; and did so for the purpose, or for purposes including the purpose, of being taken to have carried throughout the same business test period the same business as it carried on immediately before the test time.
- (4) So far as the same business test is applied for the purposes of Subdivision 165-B (which is about working out the taxable income and tax loss for the income year of change of ownership or control) the company also does *not* satisfy the test if, at any time during the same business test period, it incurs expenditure:
 - (a) in carrying on a business of a kind that it did not carry on before the test time; or
 - (b) as a result of a transaction of a kind that it had not entered into in the course of its business operations before the test time.