



Australian Government

Australian Taxation Office

Consolidation – implications when buying a wholly-owned business entity

This guide highlights certain issues you may need to consider when acquiring interests in an entity affected by consolidation.



The *Consolidation reference manual* provides detailed information on the operation of consolidation.



For more information or to obtain other consolidation products visit our website at www.ato.gov.au

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If you feel this publication does not fully cover your circumstances, please seek help from the Tax Office or a professional adviser.

The information in this publication is current at March 2007.

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! ABOUT CONSOLIDATION

- The earliest that a wholly-owned group of entities may consolidate for income tax purposes is 1 July 2002.
- Consolidation is optional but irrevocable.
- The consolidated group operates as a single entity for income tax purposes, lodging a single income tax return and then paying a single set of pay as you go (PAYG) instalments.
- The grouping provisions, which allowed, for example, intragroup transfers, capital gains tax (CGT) asset rollovers and inter-corporate dividend rebates for unfranked dividends, ended for most taxpayers on 30 June 2003. Groups wanting to continue with any form of single entity treatment for income tax purposes must choose to consolidate.
- To consolidate, a group must consist of a head company and at least one other entity – a company, trust or partnership – wholly-owned by the head company.
- 'One in, all in' – when a group consolidates, all of the head company's eligible wholly-owned subsidiaries become members.

Detailed information on consolidation is available from the Tax Office (see 'More information').

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CONTENTS

BUYING A WHOLLY-OWNED BUSINESS ENTITY	2
CLARIFYING AN ENTITY'S CONSOLIDATION STATUS	3
Timing of exit	3
IMPACT ON A LEAVING ENTITY'S TAX ATTRIBUTES	4
WHO IS RESPONSIBLE FOR TAX LIABILITIES?	4
PAYG instalments on formation	4
PAYG instalments on exit	4
Liability for the group's income tax	5
On leaving...	5
HOW DOES CONSOLIDATION AFFECT TAX HISTORY?	6
IMPACT ON TAX COSTS OF A LEAVING ENTITY'S ASSETS	6
RESEARCH AND DEVELOPMENT AND LIFE INSURANCE ENTITIES	7
RECORD KEEPING	7
MORE INFORMATION	8

BUYING A WHOLLY-OWNED BUSINESS ENTITY

- Wholly-owned corporate groups may have the option of consolidating for income tax from 1 July 2002.
- Consolidation is optional but irrevocable, and if a group consolidates all its eligible wholly-owned subsidiaries are members (the 'one in, all in' rule).
- The consolidated group operates as a single entity for income tax purposes, lodging a single income tax return and then paying a single set of pay as you go (PAYG) instalments.
- Once a group consolidates, the assets of subsidiaries are treated as if they are assets of the head company, and losses, franking credits and foreign tax credits are transferred to the head company.
- The grouping provisions, which allowed for example, intragroup loss transfers, capital gains tax (CGT) asset rollovers and inter-corporate dividend rebates for unfranked dividends, ended for most wholly-owned groups on 30 June 2003. Groups wanting to continue with any form of single entity treatment for income tax purposes must choose to consolidate.

From 1 July 2002, the prospective buyer of a wholly-owned entity should consider the entity's income tax consolidation status, which may have implications for:

- who gets the entity's tax attributes, such as its losses and franking credits
- the entity's tax liabilities, and who is responsible for them
- the entity's tax history, and
- the tax cost base of the entity's assets.

! ABOUT THIS GUIDE

This guide highlights certain issues you may need to consider when acquiring interests in an entity affected by consolidation. But it is not intended to provide detailed guidance and does not attempt to identify all possible income tax issues. Tax due diligence is a key factor in deciding to buy a business entity, and you may need to seek independent professional advice.

Specifically, this guide focuses on issues that arise for buyers when acquiring interests in one or more subsidiary members of a consolidated or consolidatable (ie eligible to consolidate) group.

If the change in ownership means that the entity or entities are also joining another consolidated group (as a consequence of the 'one in, all in' rule), the head company of the acquiring group will need to apply a set of rules and processes. Similarly, if an entire consolidatable group is being acquired, the buyer will need to consider their options in relation to consolidation.

CLARIFYING AN ENTITY'S CONSOLIDATION STATUS

If, as a result of the sale of some or all of its membership interests, a business entity is leaving a consolidated group whose formation has been notified to the Tax Office, this should be discoverable in the due diligence process.

However, if this is not the case, the entity's consolidation status will not necessarily be clear at the time it is sold. The head company of a consolidated group does not have to notify the Tax Office of the group's formation until it lodges its first consolidated income tax return – eg notification of a group consolidating on 1 July 2002 must be made by the lodgment date of the 2002–03 income tax return.

Effectively this means that the vendor can make a retrospective decision to consolidate covering the period immediately before the sale. An entity that is a member of a consolidatable group (ie eligible to consolidate) at the time of sale may later turn out to have been a member of a consolidated group at that time (see example below).

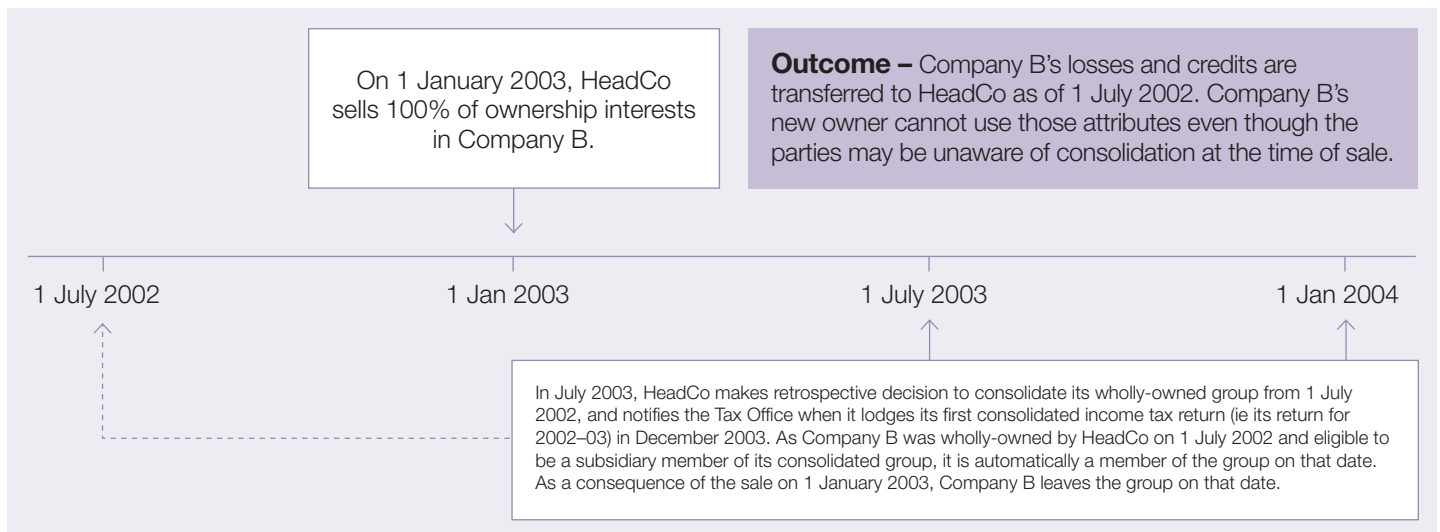
This potential outcome should be taken into account by the buyer, given that the entity's consolidation status may have implications for its tax attributes, tax liabilities, tax history and the tax costs of its assets. Any uncertainty may prompt the inclusion of warranties or similar provisions in the contract of sale to provide the buyer with a level of confidence for the future.

TIMING OF EXIT

An entity leaves a consolidated or consolidatable group when some or all of its membership interests cease to be beneficially owned (directly or indirectly) by the group's head company. From this time, the entity's income is no longer included in the head company's taxable income.

If the entity is being sold out of a consolidated or consolidatable group, the vendor and buyer will need to establish the precise timing of the change in beneficial ownership to ensure that transactions can be brought to account in the correct tax entity.

TIMELINE: Sale of a subsidiary after date of consolidation but before notification



IMPACT ON A LEAVING ENTITY'S TAX ATTRIBUTES

When an entity joins a consolidated group, its key tax attributes including losses and franking and foreign tax credits are transferred to the head company. If the entity later leaves the group, these tax attributes remain with the head company (along with any losses and credits arising out of the group's activities during the membership period).

Thus, any lack of clarity as to the consolidation status of an entity at the time of sale may have commercial and tax implications for both vendor and buyer.

! Certain other tax attributes, such as attribution and attributed tax accounts existing for controlled foreign company (CFC) and foreign investment fund (FIF) purposes, leave the group with the entity.

WHO IS RESPONSIBLE FOR TAX LIABILITIES?

An entity leaving a consolidated group may have tax related liabilities consisting of:

- any outstanding income tax debt it incurred before joining the group
- any outstanding PAYG instalments that arose during the formation period
- consolidated group tax liabilities that arose while it was a member, and
- other liabilities – eg, GST, PAYG withholding, that are not considered group liabilities.

PRE-MEMBERSHIP PERIOD TAX LIABILITIES

A member of a consolidated group is liable for any tax liabilities incurred by it before joining the group, including income tax. If the entity leaves the consolidated group it is still liable for any tax debt it incurred before joining the group.

PAYG INSTALMENTS ON FORMATION

During the formation period – ie from the date of effect of consolidation until the head company receives the group's consolidated PAYG instalment rate – subsidiary members continue to pay PAYG instalments as if they were not consolidated. They also remain liable after the formation period for any outstanding PAYG instalment payments arising during the formation period.

The head company is credited for PAYG instalments payable by a subsidiary member after the joining time of that member.

PAYG INSTALMENTS ON EXIT

If a member leaves a group during its formation period and does not immediately join another consolidated group, the leaving member's existing PAYG instalment obligation continues without interruption.

After the formation period, a subsidiary member that leaves a consolidated group and does not immediately join another consolidated group begins paying PAYG instalments on its own behalf, starting with the quarter in which it leaves the group. The instalment for the first quarter need cover only the period from when the entity leaves the group until the end of that quarter.

The leaving entity calculates its instalments using the instalment rate x instalment income method. It uses the same PAYG instalment rate as the head company used for the quarter before the one in which the entity left the group, or a varied rate. Instalments continue on this basis until the leaving entity lodges its next tax return and is given a new instalment rate or, if eligible, an instalment amount.

LIABILITY FOR THE GROUP'S INCOME TAX

The group's income tax and PAYG instalment liabilities are in the first instance the responsibility of the head company. In the event of the head company defaulting on payment by the due date, every member of the consolidated group becomes jointly and severally liable for the whole of any group liability that relates to the period while they were a member, unless there was a valid tax sharing agreement (TSA) in place.

! Amendments to original assessments up to the year of income 2004 are due and payable on the same date as the original assessment even if the amendment issues some years later. Amendments to original assessments for 2005 and later years of income are due and payable 21 days after the notice of amended assessment is given.

A member of a consolidated group who was a party to a valid TSA will have its liability limited to an amount equal to its contribution amount under the TSA. This amount can be recovered from the member by the Commissioner even though the member may have already paid an equivalent amount to the head company.

However, should the head company fail to supply a copy of the TSA within 14 days of being given a notice from the Commissioner requesting it, the group liability will be taken to have never been covered by a TSA and the members' liability will no longer be reduced by it. They will, instead, become jointly and severally liable for the whole of the group liability.

ON LEAVING...

When an entity leaves a consolidated group, the basic approach set out in the previous paragraph applies to the leaving entity for group debts that became due and payable by the head company **before** the entity left the group. This means that the entity will remain jointly and severally liable for a group liability or liable for their contribution amount under a valid TSA, despite having left the group.

For group liabilities that relate to a period during which the exiting entity was a member of the group but become due and payable by the head company **after** the entity leaves the group, the entity can generally leave clear of any further payment obligation provided it has paid the head company its required contribution (or a reasonable estimate of it) under a valid TSA, and, in some circumstances where required, given a copy of the TSA to the Commissioner in accordance with various conditions.

! TSAs have no effect on a subsidiary member's formation period PAYG instalment liabilities.

More information on tax liabilities is provided in Chapter 35 of the ATO Receivables Policy and in the *Consolidation reference manual*, sections B3-4 'Managing obligations', C9-7-110 'Tax sharing agreements' and C9-7-510 'Tax sharing agreement based on percentage of profit methodology' (see 'More information').

If the entity is leaving a **consolidated** group whose formation has been notified to the Tax Office by the time of sale, ensuring that the clear exit conditions are satisfied at the time of sale should be relatively straightforward. However, if the entity is leaving a **consolidatable** group, the buyer may need to ensure that the contract of sale provides a warranty or other means of satisfying the clear exit conditions in the event of a future retrospective notification of consolidation by the head company.

HOW DOES CONSOLIDATION AFFECT TAX HISTORY?

When an entity joins a consolidated group, the head company inherits the entity's income tax history (for example, the pre-CGT status of the entity's assets). When an entity leaves a consolidated group, the entity inherits the tax history of the assets, liabilities and business it takes with it. Given that things may have changed while the entity was a member of the group, the tax history on exit from a consolidated group may not be the same as the tax history on entering the group.

IMPACT ON TAX COSTS OF A LEAVING ENTITY'S ASSETS

When an entity joins a consolidated group, its assets are given new tax costs (subject to use of the transitional formation option of retaining existing tax costs). This is achieved by aligning the tax costs of the entity's assets with the cost of acquiring the membership interests in the entity and the value of its liabilities. When an entity is sold out of a consolidated group, the process is reversed and the head company's cost of membership interests in the entity is derived from and aligned with the tax costs of the assets that the entity takes with it, less its liabilities.

Given this, the inherited tax costs of the assets of an entity that is sold may vary depending on whether the entity has been a member of a consolidated group.

Thus, if the consolidation status of an entity at the date of sale is unclear, this may have implications for the tax costs of its assets.

RESEARCH AND DEVELOPMENT AND LIFE INSURANCE ENTITIES

Special rules apply where an entity is engaged in research and development activities or is a life insurance company. More information is provided for in:

- **Research and development:** the Explanatory Memorandum to the New Business Tax System (Consolidated and Other Measures) Bill (No. 1) 2002, Chapter 7, and
- **Life insurance entities:** sections, C9-6-110, C9-6-510, C9-6-520 and C9-6-530 of the **Consolidation reference manual** (see 'More information').

RECORD KEEPING

Taxpayers are required to keep records that explain all transactions relevant to their income tax obligations. In a consolidated group this obligation lies with the head company, though a subsidiary member may have custody of the records. When an entity leaves a group, both the head company and the leaving entity should ensure they retain copies of, or have access to, the relevant tax records required to meet their obligations.

More information on record keeping obligations under consolidation is provided in the Consolidation reference manual, section C9-2 'Record keeping guidelines and checklist' (see 'More information').

MORE INFORMATION

The *Consolidation reference manual* provides detailed information on the rules and processes summarised in this guide.

For tax technical enquiries either:

- look on the consolidation website **www.ato.gov.au/consolidation**,
- if you are a tax agent, phone **13 72 86 FKC 213**,
- if you are in business, phone **13 24 78**, or
- email **consolidation@ato.gov.au**

If you do not speak English well and need help from us, phone the Translating and Interpreting Service (TIS) on **13 14 50**.

People with a hearing or speech impairment with access to TTY or modem equipment can phone **13 36 77**.

People without TTY or modem equipment can phone the Speech to Speech Relay Service on **1300 555 727**.

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