



## Indirect tax sharing agreement – reasonable allocation of indirect tax law liability

Policy guidelines on the reasonable allocation of indirect tax law liability under an indirect tax sharing agreement.

**Last updated** 25 May 2017

A GST group may have an indirect tax sharing agreement (ITXSA) specifying the amounts each member contributes to the group's indirect tax law liabilities for a particular tax period. The ITXSA may specify:

- fixed contribution amounts for each contributing member
- a method of allocation under which contribution amounts are determined.

Either way, the contribution amounts calculated under the ITXSA must represent a 'reasonable allocation' of liabilities among the group's representative member and contributing members.

### See also

- Paragraph 444-90(1A)(c) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)

### Reasonable methods of allocation

There's no prescribed method that must be used to allocate a group's indirect tax law liability.

### Other contractual arrangements

Groups may use an ITXSA for other purposes.

### Arrangements to prejudice recovery

When a contributing member may not be able to pay its full contribution amount.

## Examples

Examples of reasonable allocation of indirect tax law liability under an indirect tax sharing agreement.

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## Reasonable methods of allocation

There's no prescribed method that must be used to allocate a group's indirect tax law liability.

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The following are examples of what the ATO would consider reasonable bases of allocation:

- [allocation based on each member's contribution to the liability](#)
- [proportional allocation based on historical information](#)
- [allocation based on each member's ability to pay](#).

We acknowledge that these allocation methods may result in certain entities being liable for less than, or more than, they would be if they were not members of a group.

Other methods using financial information normally available to the group may also be acceptable, provided each contributing member's contribution amount is a reasonable allocation of the total indirect tax law liability of the group for that tax period.

For each allocation method it's assumed that allocations are based on the sum of all indirect tax liabilities for that tax period, such that each contributing member receives an allocation based on a portion of the total amount of the liabilities. However, it's also possible for each indirect tax liability to be accounted for and apportioned separately. For example, a group may separate its GST, LCT and WET component liabilities and apply the allocation method or methods to each individual component against the contributing members. Note that:

- The legislation requires that ultimately there must be a single amount ('a particular amount') that is determinable in respect of each contributing member.
- This amount must represent a reasonable allocation of the group's liability among the representative member and the contributing members.

## Allocation based on each member's contribution to the liability

Under this method of allocation, each member's contribution amount is calculated as if that member were not part of a GST group, ignoring intragroup transactions. This may result in some members having a liability and others being in a net credit position (notional refund members).

The credits that accrue to notional refund members (that is, the input tax credits that remain after offsetting amounts of GST) may be:

- [transferred to, and apportioned among, members with notional debt](#)
- [not transferred to members with notional debt.](#)

## Credits transferred

Notional refund members may choose to transfer their credit to other group members, as follows:

- determine the notional indirect tax liability for each contributing member on the basis that it is not part of a group, ignoring intragroup transactions
- allocate the notional refund members a 'Nil' liability under the ITXSA, and
- apportion the amount of any credits to members with a tax liability; or allocate to each ITXSA contributing member (that still has a notional tax liability) a portion of the indirect tax liability on a pro rata basis.

Any increase in the group's liability following an amended assessment resulting from incorrectly over-claimed credits by a notional refund member should, in principle, increase the other members' contribution amounts, which had previously been reduced by the allocation of the (incorrectly claimed) credits. Although it was the notional refund member who incorrectly over-claimed the credits, the ITXSA allocation methodology spreads the adjustment across other members of the group. This does not jeopardise the reasonableness of the allocation.

### See also

- [Example 1: Contribution to liability method, where credits are allocated](#)

## Credits not transferred

The ITXSA may specify that the credits accrued by notional refund members should not be used by the other group members – that is, the notional refund members will have a 'nil' contribution amount, but the amount of their credits will not be redistributed among the other members of the group.

As the contribution amounts of the other members are not reduced by the notional refund members' credits, the total amount of the ITXSA contribution amounts payable by all contributing members will exceed the net amount payable by the group. This method of allocation may still be considered reasonable.

Any increase in the group's liability following an amended assessment resulting from incorrectly over-claimed credits by a notional refund member will, in principle, be attributed to that member such that it will have a contribution amount equal to the amount of the increased liability. The contribution amounts of the other members will not need to be amended.

**See also**

- [Example 2: Contribution to liability method, where credits are not allocated](#)

## **Proportional allocation based on historical information**

Unquantified indirect tax law liabilities may be allocated proportionally among members based on historical information if, at the time an ITXSA is put in place, the amount of the liabilities it is intended to cover have not been determined. For instance, the amount allocated to a contributing member could be calculated using the average contribution of that entity to indirect tax law liabilities over the previous 12 months. Allocations calculated using this method may need to be adjusted if there are changes in the group's structure (such as entries or exits), or changes to the individual member's operations. Depending on the timing and significance of these changes, a new ITXSA using a different methodology may be required.

## **Allocation based on each member's ability to pay**

Liabilities may be allocated on the basis of each contributing member's ability to pay that liability.

Such an allocation may be considered unreasonable if, at the time of the allocation, the directors were aware that events would occur that would severely affect a member's ability to pay their allocation, but ignored that information.

If the entire group lacked sufficient funds to meet its liability for a tax period at the due date for lodgment of the GST return, an allocation may be considered reasonable despite one or more contributing members being unable to pay their contribution (for example, the entire group was insolvent as opposed to only one or more contributing members being insolvent).

**See also**

- [Examples](#)
- [Other contractual arrangements](#)
- [Arrangements to prejudice recovery](#)

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## Other contractual arrangements

Groups may use an ITXSA for other purposes.

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Groups may use an ITXSA for other purposes, provided these do not affect the reasonableness of the allocation under the ITXSA or prejudice the rights of the Commissioner to recover the debt. For instance, the following internal arrangements are not relevant to determining whether there has been a 'reasonable allocation', even if they are included in the ITXSA:

- financing of ongoing tax liabilities (even if this requires different contributions from group members than would be ascertained under the 'reasonable allocation' clauses)
- the treatment of refunds received
- the requirements for balancing adjustments between the ITXSA liabilities and other tax liabilities as shown in entities' accounts.

It is anticipated that a group may choose to incorporate the terms of the tax funding or other private contractual arrangements in a separate agreement. Again, these agreements are generally of no concern to the Commissioner, subject to the 'prejudice recovery' provisions in the legislation – that is, while a tax funding or other arrangement may have no bearing on the determination of whether there has been a 'reasonable allocation', if it is designed to frustrate the ability of a member to pay its contribution amount, it would be seen to 'prejudice recovery' under paragraph 444-90(1C)(b) of Schedule 1 to the TAA.

### See also

- [Reasonable methods of allocation](#)
- [Examples](#)
- [Arrangements to prejudice recovery](#)

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## Arrangements to prejudice recovery

When a contributing member may not be able to pay its full contribution amount.

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It is recognised that the financial position of individual members may change between the date on which the ITXSA is entered into and the date (if any) on which the contribution amount is pursued by the Commissioner, particularly where the contribution amount is pursued some years after the due date. Accordingly, it is possible that a contributing member may not be able to pay its full contribution amount by the time the Commissioner seeks to recover that amount.

However, the Commissioner will recognise the ITXSA as being valid provided that:

- the original allocation was in accordance with the methodology of the ITXSA and was reasonable at the due date for lodgment of the GST return, and
- there are no adverse circumstances relating to the validity of the ITXSA (for example, the ITXSA was part of an arrangement to prejudice recovery)..

The provisions relating to ITXSAs will not apply, and the members will therefore be exposed to joint and several liability for the full amount of the group's indirect tax law liability for the tax period, if:

- the ITXSA was entered into as part of an arrangement
- a purpose of the arrangement was to prejudice the recovery by the Commissioner of the indirect tax amount.

Such arrangements include (for example) where the allocation to a contributing member was based on:

- capacity to pay, seemed reasonable at the time the ITXSA was made, and remained so at the due date for lodgment of the group's GST return, but it was always known that, by the time the Commissioner may attempt to collect from that member, its circumstances would be such that it would not be in a position to meet its liability
- notional tax liability, but the individual amounts were artificially distorted by selective allocations of credits or other measures that appeared designed to shift the liabilities to entities that are less likely to be able to meet them.

Some of the factors to be taken into account in determining whether an arrangement had a purpose of prejudicing recovery include:

- the disposing of assets in solvent or asset-rich members of the group
- allocation of liability to a member where a foreseeable event would cause it to become unable to pay (for example, litigation in progress)
- the uncommercial sale of assets.

The existence of an ITXSA in itself would not be seen as an arrangement to prejudice recovery.

## See also

- [Reasonable methods of allocation](#)
- [Examples](#)
- [Other contractual arrangements](#)

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## Examples

Examples of reasonable allocation of indirect tax law liability under an indirect tax sharing agreement.

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- [Example 1: Contribution to liability method, where credits are allocated](#)
- [Example 2: Contribution to liability method, where credits are not allocated](#)
- [Example 3: Chain supply scenario](#)

### Example 1: Contribution to liability method, where credits are allocated

X Co is the representative member of the GST group (the group).

A Co, B Co and C Co are also members of the group and have entered into an ITXSA with X Co covering indirect tax amounts payable in respect of period Y. The ITXSA was entered into before X Co was required to give the Commissioner a GST return for period Y.

The members ordinarily make supplies to, and acquisitions from, entities outside the group except for A Co, which primarily makes supplies to the other members of the group.

The method of allocating the contribution amounts for each member of the group under the ITXSA is based on each member's individual contribution to the group's liability (the contribution to liability method) taking GST, input tax credits and adjustments into account. The contribution amounts are subsequently allocated on a pro rata basis.

For the purposes of applying the contribution to liability method, A Co's net indirect tax law liability is determined to be a credit as a result of primarily making supplies to other members of the group (which are treated as not being taxable supplies). This credit is applied to, and reduces, the indirect tax law liabilities payable by the group.

The group's indirect tax law liability for period Y remains unpaid and the Commissioner commences recovery action against the members of the group.

The table below summarises the information from the ITXSA that X Co, as the representative member, provides the Commissioner with respect to period Y.

#### Example of information from X Co to the Commissioner for period Y

	GST group (X Co is the representative member)	Contributing members' liabilities			
		X Co	A Co	B Co	C Co
Indirect tax law liabilities: GST - ITC	\$60,000	\$50,000	(\$40,000)	\$25,000	\$0
Balance payable	\$60,000				
% of liability	100%	50%	0%	25%	0%
ITXSA contribution amounts	\$60,000	\$30,000 (Note - for the representative member, this is a notional allocation)	\$0	\$15,000	\$0

B Co and C Co's exposure to joint and several liability is limited each to \$15,000.

Despite A Co having a 'nil' contribution amount it is still necessary for it to be a participant in the ITXSA to avoid joint and several liability.

While X Co as the representative member remains 100% liable for the group debt, it can be allocated an amount under the ITXSA in accordance with a methodology aimed at a reasonable allocation among the representative member and the contributing members. As a result, while X Co has a notional allocation of \$30,000 under the ITXSA, it continues to be fully liable for the debt, and the contributing members' liabilities are limited to the extent of their allocations pursuant to the ITXSA.

If an amended assessment issues, reversing A Co's credit and thereby increasing the group's indirect tax law liability by \$40,000, the members' contribution amounts under the ITXSA would need to be amended. The contribution amounts would be increased, in accordance with the allocation method, by the following amounts:

#### Example of increase to contribution amounts

	GST group (X Co. is the representative member)	Contributing members' liabilities			
		X Co	A Co	B Co	C Co
Additional liability (over claimed credits)	\$40,000				
% of liability	100%	50%	0%	25%	25%
<b>Increase to contribution amounts</b>	<b>\$40,000</b>	<b>\$20,000</b> (Note - for the representative member, this is a notional allocation)	<b>\$0</b>	<b>\$10,000</b>	<b>\$10,000</b>

### Example 2: Contribution to liability method, where credits are not allocated

X Co is the representative member of the GST group (the group).

A Co, B Co and C Co are also members of the group and have entered into an ITXSA with X Co covering indirect tax amounts payable in respect of period Y. The ITXSA was entered into before X Co was required to give the Commissioner a GST return for period Y.

The members ordinarily make supplies to, and acquisitions from, entities outside the group except for A Co, which primarily makes supplies to the other members of the group.

The method of allocating the contribution amounts for each member of the group under the ITXSA is based on each member's individual contribution to the group's liability (the contribution to liability method). However, each member's allocation is not made on a pro rata basis.

For the purposes of applying the contribution to liability method, A Co's net indirect tax law liability is determined to be a credit as a result of primarily making supplies to other members of the group (which are treated as not being taxable supplies). This credit reduces the indirect tax law liabilities payable by the group.

The group's indirect tax law liability for period Y remains unpaid and the Commissioner commences recovery action against the members of the group.

The table below summarises the information from the ITXSA that X Co, as the representative member, provides the Commissioner with respect to period Y.

**Example of information from X Co to the Commissioner for period Y**

	GST group (X Co is the representative member)	Contributing members' liabilities			
		X Co	A Co	B Co	C Co
Indirect tax law liabilities: GST - ITC	\$80,000	\$20,000	(\$40,000)	\$50,000	\$50,000
Balance payable	\$80,000				
ITXSA contribution amounts	\$120,000 (but the Commissioner cannot recover more than the total of \$80,000)	\$20,000 (Note - for the representative member, this is a notional allocation)	\$0	\$50,000	\$50,000

While X Co as the representative member remains 100% liable for the group debt, it can be allocated an amount under the ITXSA in accordance with a methodology aimed at a reasonable allocation among the representative member and the contributing members. As a result, while X Co has a notional allocation of \$20,000 under the ITXSA, it continues to be fully liable for the debt, and the contributing members' liabilities are limited to the extent of their allocations pursuant to the ITXSA.

As the contribution amount for each member is not calculated on a pro rata basis, B Co and C Co's liability remains at \$50,000. This is the indirect tax law liability that B Co and C Co would have on their own if the representative member was not responsible for the obligations and entitlements of the group.

As a result, the sum of all the members' contribution amounts (including X Co's notional contribution amount) is more than the GST group's total indirect tax law liability. In this case, the sum of the members' contribution amounts is \$120,000, while the GST group's total indirect tax laws liability is only \$80,000.

However, the Commissioner cannot recover more than the sum of the group's total indirect tax law liability of \$80,000 from the group. That is, while the Commissioner may recover the full amount of the contributing liability allocated to a member, he cannot recover more than \$80,000 from the group in total. Therefore if \$50,000 is recovered from B Co, the Commissioner can only recover the balance of \$30,000 from the remaining members. Alternatively, the Commissioner has the right to

recover up to \$50,000 from C Co, but if this debt is fully satisfied by C Co, the Commissioner can only pursue the balance of \$30,000 from X Co and B Co.

If an amended assessment issues, reversing A Co's credit and thereby increasing the group liability by \$40,000, only A Co's contribution amount would need to be amended. In this case, A Co's contribution amount would be increased by \$40,000, representing the amount it had over-claimed. The other members' contribution amounts under the ITXSA would not need to be amended.

### Example 3: Chain supply scenario

X Co is the representative member of the group.

A Co, B Co and C Co are members of the group and have entered into an ITXSA with X Co covering indirect tax amounts payable in respect of period Z. The ITXSA was entered into before X Co was required to give the Commissioner a GST return for period Z.

The group manufactures and sells goods through a supply chain comprising the members. The goods are manufactured by X Co and supplied to A Co, which in turn supplies to B Co, and then to C Co, which as the retailing entity supplies the goods to customers outside of the group.

As with example 1, the group uses the contribution to liability method under the ITXSA in which the member's contribution amount is based on its individual contribution to the group's liability.

The group's indirect tax law liability for period Z remains unpaid and the Commissioner commences recovery action against the members of the group.

The table below summarises the information from the ITXSA that X Co, as the representative member, provides the Commissioner with respect to period Z.

#### Example of information from X Co to the Commissioner for period Z

	GST group (X Co is the representative member)	Contributing members' liabilities			
		X Co	A Co	B Co	C Co
Indirect tax law liabilities: GST - ITC		\$0	\$0	\$0	\$60,000

Balance payable	\$60,000				
% of liability	100%	0%	0%	0%	100%
ITXSA contribution amounts	\$60,000	\$0	\$0	\$0	\$60,000

As intragroup supplies and acquisition are not treated as taxable supplies or creditable acquisitions for GST purposes, the only entity that makes taxable supplies in period Z is C Co, as the supplier of the goods to customers outside of the group. Consequently, 100% of the group's indirect tax law liability is attributed to C Co under the terms of the ITXSA.

Despite X Co having a 'nil' notional allocation under the ITXSA it continues to be responsible for 100% of the liability.

Despite A Co and B Co having 'nil' contribution amounts it is still necessary for each entity to be a participant in the ITXSA to avoid joint and several liability.

This method of allocation may be considered reasonable provided there is no arrangement that has a purpose of prejudicing recovery of the liability. A greater degree of scrutiny will be given to the matter if, for example, C Co possesses insufficient assets to satisfy the liability.

**See also**

- [Reasonable methods of allocation](#)
- [Arrangements to prejudice recovery](#)

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