Tax sharing agreements

In a consolidated group, the head company is responsible, on behalf of the group, for the payment of income tax related liabilities (the group liability). If the head company fails to discharge in full its obligation to pay the group's tax liability by the time the tax is due (the head company's due time), subsidiary members (contributing members) that were part of the group for all or part of the liability period become jointly and severally liable for the group liability.

(Note that the group liability does not include PAYG instalments payable by the head company that relate to instalment quarters that ended before the Tax Office gave the head company its initial head company instalment rate.
→ subsection 721-10(3), ITAA 1997)

Contributing members can, however, avoid this liability by entering into a tax sharing agreement (TSA) before the head company's due time. A TSA is an agreement between the head company and one or more contributing members that allows the group liability to be apportioned between group members according to a methodology set out in the agreement. Note that the liability of the head company for the total debt continues whether a TSA exists or not.

These guidelines provide an overview of the provisions relating to TSAs, and should be read in conjunction with 'Collection of Consolidated Group Liabilities' in the *ATO Receivables Policy* → 'References' p. 14. However, a company director should always seek independent professional advice when deciding whether to enter into a TSA and what the form and content of that agreement should be.

Legislative background

Division 721 of the *Income Tax Assessment Act 1997* (ITAA 1997) deals with the liability for payment of tax and some other liabilities when the head company fails to pay on time. It establishes:

- how consolidated groups can apportion the group's tax liabilities through TSAs
- how subsidiary companies can effect a clear exit from a consolidated group through the use of a valid TSA, and
- the circumstances in which TSAs are considered valid for the purposes of Division 721.

Subsection 265-45(2) of the *Taxation Administration Act 1953* (TAA 1953) provides for a right of contribution when persons are jointly liable for a tax-related liability. If a group member pays all or part of a debt for which it is jointly liable, it may be able to seek a contribution towards that amount from other members who are also jointly liable.

Group liability

In accordance with the single entity rule, the head company is responsible for a consolidated group's income tax liabilities.

→ 'Consolidation – key points and pathway', B0-1; 'Glossary', A2

A list of group liabilities is set out in subsection 721-10(2) of the ITAA 1997. When the head company fails to satisfy a group liability by the due time, each contributing member becomes jointly and severally liable, with the head company, for the outstanding amount, unless:

- that member is prohibited by the effect of an Australian law from entering into arrangements that would subject it to joint and several liability, or
- the group liability was covered by a valid TSA that allocates the liability between the members of the group on a reasonable basis.

Valid tax sharing agreements

The members of a consolidated group may avoid the consequences of joint and several liability by entering into a valid TSA with the head company. A TSA is an agreement between the head company and subsidiary members (contributing members). It can be used to allocate a group liability among a number of contributing members, provided that allocation is a 'reasonable allocation'.

Each contributing member covered by a valid TSA is liable for the amount determined under that agreement. A TSA may make a contributing member liable for all, part, or none of a group liability.

Under section 721-25, a group liability will only be covered by a TSA if:

- the agreement between the head company and contributing members exists immediately before the head company's due time
- the agreement determines how the relevant group liability is to be allocated to the contributing members (the contribution amount)
- the allocation of the contribution amounts between the head company and contributing members is a reasonable allocation and accounts for the entire group liability
- the group liability is covered by not more than one TSA, and
- the agreement complies with any requirements set out in the regulations (currently, there are no relevant regulations).

Note that, in respect of income tax liability, the third condition is taken to be satisfied if there is a reasonable allocation of the group liability reduced by the PAYG instalment credits available to the head company under sections 45-30 and 45-865 of Schedule 1 to the *Taxation Administration Act 1953*.

A group liability is not covered by a TSA if:

- it would also be covered by one or more other TSAs (see note below), or
- the agreement was entered into as part of an arrangement, a purpose of which was to prejudice the Tax Office's recovery of some or all of the group liability, or

- the Commissioner serves a notice on the head company in relation to the group liability requesting a copy of the TSA in the approved form and it is not provided within 14 days.

Note that a given TSA may cover any number of group liabilities, and a group may have more than one TSA. However, each group liability must be covered by only one TSA. → subsection 721-25(1B), ITAA 1997; paragraphs 2.183 2.186 of the Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 2) Bill, 2004

Diagram 11.1 (see next page) from the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002 illustrates the application of TSAs to group liabilities.

Subsection 721-25(3) states that a copy of a TSA must be given to the Commissioner, on request, in the 'approved form'. Because a TSA is an agreement between the head company and other members of the group, a specific TSA form does not exist, but the Commissioner has specified the minimum requirements that a TSA must comply with in order to be produced in the 'approved form'.

The requirements outlined in the *ATO Receivables Policy* chapter headed 'Collection of Consolidated Group Liabilities' stipulate that each TSA must:

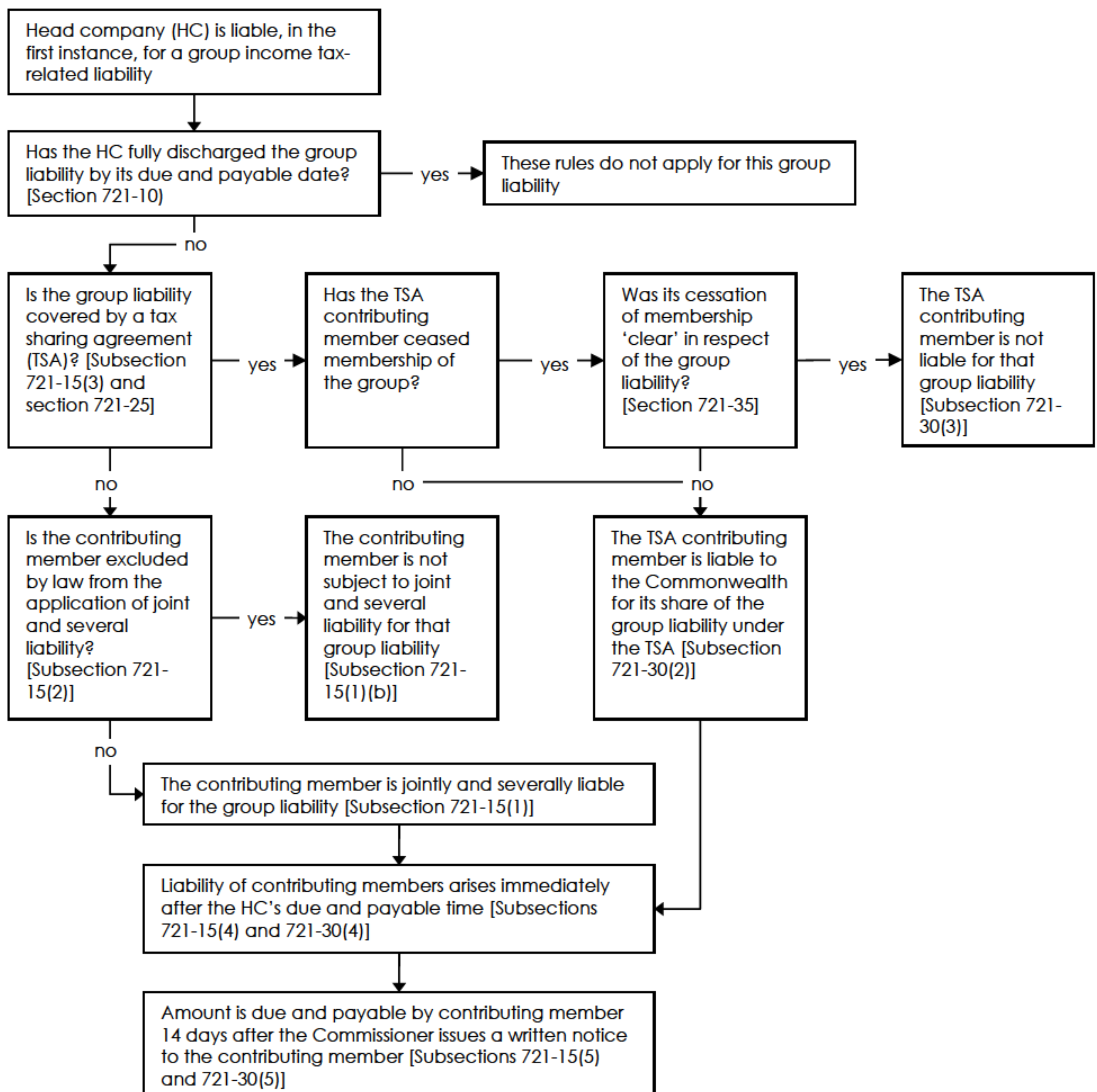
- be in writing
- show the date of execution
- specify the names of the head company and each TSA contributing member
- specify what group liability or liabilities it covers
- specify the method used to allocate the group liability or liabilities, which must provide for a reasonable allocation of the entire group liability or liabilities
- be properly executed by or on behalf of the head company and each contributing member that is a party to the agreement (i.e. the TSA contributing members)
- either:
  - specify the exact contribution amount for each contributing member for the relevant liability, or
  - *if and when required to be produced to the Commissioner*, include a schedule signed by the head company that:
    - specifies the relevant liability or liabilities and period(s) as specified in the Commissioner's notice to produce
    - states the name and ABN or ACN of the head company and each TSA contributing member
    - states the contribution amount of each TSA contributing member in respect of the relevant liability or liabilities

- declares that 'the schedule includes the names of all the TSA contributing members in relation to that liability or liabilities for that/those period(s) and the contribution amount or amounts as calculated under the TSA'.

- *if and when required to be produced to the Commissioner*, include any deeds of assumption in relation to the particular liability or liabilities for the particular period(s).

A new TSA may be necessary if there are changes in the consolidated group's structure (because of the entry or exit of members), or changes to an individual member's operations.

Diagram 11.1



Reasonable allocation

The contribution amounts for each of the contributing members must represent a reasonable allocation of the total group liability.

→ paragraph 721-25(1)(c)

This manual cannot cover all possible methods for achieving a reasonable allocation of a group liability, but examples of reasonable allocations include:

- allocations based on the percentage share of the group accounting profit for the preceding income year
- allocations based on the percentage share of the group accounting profit for the current income year, or
- allocations based on each member's ability to pay the liability.

An example of an unreasonable allocation would be one that allocated the group liability based on the percentage share of the group profit, while excluding members that were major contributors to that profit. The ultimate determination of what is a 'reasonable allocation' will of course rest with the courts.

Formal notice requesting a copy of a TSA

If the Tax Office decides to pursue one or more members for an unpaid group liability, it may issue a notice to the head company under subsection 721-25(3). The head company has 14 days after service of the notice to produce a copy of the relevant TSA in the approved form. If the TSA is not produced, the group liability will be considered never to have been covered by a TSA, and all contributing members will be jointly and severally liable for the group liability. (Note that if a TSA does not exist at the head company's due time, the contributing members' liability arises just after that time, not at the time of any later non-production of the TSA.)

The Commissioner may defer the time for lodgment of a TSA under section 388-55 of the TAA 1953. As a TSA must exist before the head company's due time to be valid, such a deferral would only be granted in exceptional circumstances. → ATO Receivables Policy, 'Deferral of the Due Date for Lodgment and Suspension of Lodgment Action'

Actions prejudicial to recovery

Under subsection 721-25(2), a group liability is not covered by a TSA if the TSA was entered into as part of an arrangement, a purpose of which was to prejudice the recovery of some or all of the group liability by the Tax Office. Actions that might lead to such a determination include:

- disposing of interests in solvent or asset-rich members of a group (while retaining control) to the extent that they are no longer considered to be part of the consolidated group
- allocation of a liability to a member when its likely inability to pay is foreseeable (e.g. because of litigation in progress), or
- uncommercial sale of assets.

Amended liabilities

Generally, a liability resulting from an amendment or revision is considered to be covered by a TSA if the TSA refers to the underlying liability to which the amendment or revision relates. For example, a reference to the group liability for income tax relating to the 2002–03 income year would cover any amendment to that liability, provided the TSA did not specify fixed amounts in relation to the original liability.

Depending on the method used, some groups may wish to consider inserting a clause into their TSAs that provides for any increase in the group liability arising from an amendment or revision to be allocated to the entity or entities responsible for the understatement.

Note

Due and payable date

For income tax assessments for 2003-04 and earlier years, amended assessments become due and payable on the same date as that applying to the original assessment. The debts in both original and amended assessments relate to the same liability, and must therefore be covered by the same TSA. The TSA methodology must remain unchanged, though the Commissioner may require the production of an attachment to the TSA to disclose the new allocations to members arising from the amended or revised liability.

For income tax assessments for 2004-05 and later years, the due date for amended assessments is 21 days from when the taxpayer is notified of the amendment. Although the due date for an amended assessment for these years is later than that of the original assessment, the debts in both original and amended assessments relate to the same liability, and therefore must also be covered by the same TSA. The TSA must be in place – and all its requirements met – before the due time of the original assessment. The TSA methodology must also remain unchanged.

Tax Office review of TSAs

The Tax Office cannot provide a binding view on the validity of a TSA, but it will regularly update guidelines.

If the Tax Office has received a copy of a TSA – whether informally or through a request under subsection 721-25(3) – and has not taken further action, this does not imply that it considers the TSA to be valid or has determined that it provides a reasonable allocation of the relevant group liability.

Clear exit

Under section 721-35, a contributing member can leave a group clear of a specific group liability if:

- it ceases to be a member of the group before the due date of the group liability
- before the leaving time, it pays to the head company an amount equal to the contribution amount or, if that amount cannot be determined at that time, a reasonable estimate of that amount, and
- the member's exit from the group is not part of an arrangement, a purpose of which was to prejudice the recovery of all or part of the group liability by the Tax Office.

As noted before, a group liability is held not to be covered by a TSA where the head company fails to comply with a request to give the Tax Office a copy of the relevant TSA in the approved form within 14 days → 'Valid tax sharing agreements', p. 2. Nevertheless, a contributing member that fulfils the above conditions will achieve a clear exit provided it gives a copy of the TSA to the Tax Office in the approved form within 14 days of the Commissioner giving the contributing member notice of its joint and several liability.

→ subsection 721-15(3A), ITAA 1997

A contributing member cannot have a clear exit if there is a group liability not covered by a valid TSA or if the group liability is due and payable before it ceases to be a member of the group. Note that for income tax assessments for 2003-04 and earlier years, the due date for payment of an amended income tax assessment or revised PAYG instalment is the same as the date the original liability was payable.

Reasonable estimate of contribution amount

When a leaving entity wishes to leave a group clear of a particular group liability, and its contribution amount under the TSA cannot be determined before the leaving time, paragraph 721-35(c) provides that a reasonable estimate of that contribution amount must be made. This reasonable estimate must be based on the TSA. Depending on the particular TSA's methodology, actual income figures or projected cash flows may be used.

Payment of contribution

Documentary evidence that the leaving member has paid the contribution amount, or a reasonable estimate of that amount, to the head company must be retained by the leaving entity in case it is later needed to prove that it left the group clear of a particular group liability. Standard commercial documentation is generally sufficient.

A mere book entry is not sufficient as a form of payment.

Actions prejudicial to recovery

A contributing member will not leave the group clear of a particular group liability if its exit was part of an arrangement, a purpose of which was to prejudice the Tax Office's recovery of some or all of the group liability. This might apply, for example, if the exiting entity is sold for less than its market value.

Amended liabilities

For 2003-04 and earlier years

For income tax assessments for 2003-04 and earlier years, any increase in group liabilities following an amendment or revision is due for payment on the same date as the original liability.

If the entity leaves the group *before* the due time of *both* the original and amended assessments, it can achieve a clear exit if it makes a payment of its (anticipated) post-amendment contribution amount (that is, the contribution amount that takes into account the anticipated amended assessment), or a reasonable estimate of the amount, to the head company, before leaving.

A clear exit may also be obtained if the entity could not have expected that an amended assessment would be issued at a later time and makes a payment of its pre-amendment contribution amount or a reasonable estimate of that amount. In this case, the amount of the increase arising from the amendment would not be due to the leaving entity's activities.

Conversely, a clear exit would not be obtained if the entity could have expected that an amended assessment would be issued at a later time and it does not make a proper contribution to the additional liability.

The leaving entity will usually need to consult with the head company to determine its contribution amount, or a reasonable estimate of the amount. The head company will often be in a better position to anticipate any future amended assessments of the group liability, and therefore to advise of any likely increase in the contribution amount.

Where an amended assessment results from unforeseen or undisclosed activities of another subsidiary of which neither the leaving entity nor the head company were aware (at the leaving time), this may not detract from the 'reasonableness' of the entity's pre-amendment contribution amount and therefore its ability to achieve a clear exit.

If the entity leaves the group at any time *after* the due time of the original assessment of the relevant group liability, the clear exit provisions do not apply to that liability even if the amended assessment has not been issued at the leaving time.

This is because section 721-35 requires the leaving time to be 'before the head company's due time' for that group liability. For income years 2003-04 and earlier, the due date of amended assessments is the same date as the due date of the original assessment. Therefore an entity that leaves after this date cannot achieve a clear exit for that liability.

If the contribution amount for the entity is a fixed sum under the TSA, and does not allow for a variation following the issue of an amended assessment, the allocation may not be considered to be 'reasonable' under paragraph 721-25(1)(c). The group liability in question may therefore not be covered by the TSA.

For 2004-05 and later years

For income tax assessments for 2004-05 and later years the due date for amended assessments is 21 days from when the taxpayer is notified of the amendment.

If the entity leaves the group *before* the due time of *both* the original and amended assessments, its clear exit position is similar to the position of an entity in relation to 2003-04 and earlier income tax assessments.

If the entity leaves the group *after* the due time of the original assessment, but *before* the amended assessment is issued, it may still

have the benefit of the clear exit provisions in respect of amended assessments for 2004-05 and later years.

This is because the due time of an amended assessment for these years is prospective, such that the leaving time of an entity in this situation can be said to be 'before the head company's due time'.

A clear exit can be achieved in this case if the entity makes a payment of its (anticipated) post-amendment contribution amount (that is, the contribution amount that takes into account the anticipated amended assessment), or a reasonable estimate of the amount, to the head company, before leaving.

However, it must be remembered that while the due date for an amended assessment for these years is later than that for the original assessment, the debts in both original and amended assessments relate to the same liability. As such they must be covered by the same TSA, and so to achieve a clear exit for the amended assessment the TSA must have been in place before the original assessment's due time. The TSA methodology must also remain unchanged.

Effect of a TSA on amended liabilities

In some cases a TSA can be used to limit a leaving entity's exposure to that part of an increased group liability, relating to a period in which it was a contributing member, that resulted from its own activities.

→ ATO Receivables Policy, Chapter 35 'Collection of Consolidated Group Liabilities'

Issues for contributing members

Contributing members need to consider their statutory and common law responsibilities before becoming a party to a TSA. Issues they need to consider may include:

- **the need for a TSA**:
  - creditors or potential purchasers of the company may wish to examine the terms of the TSA
  - there could be a serious impact on the company's solvency if it does not enter into a TSA (in the event that the Tax Office takes recovery action against it under the joint and several liability provisions)
  - a company can only make a clear exit from a group if it is a party to a TSA
- **time for preparation:** the TSA must be drafted and executed before the head company's liability becomes due and payable
- **regular revision:** TSAs may need to undergo regular revisions as members are purchased by interests outside the consolidated group, or new members are brought into the group – such changes may affect the reasonableness of TSA allocations of group liability, and
- **other matters that may be included in the TSA**: other related issues may be addressed in a TSA provided they do not invalidate its prime purpose – such as, for example, subvention payments or contributions by members to ongoing tax payments.

Frequently asked questions

1. Where can I obtain detailed advice from the ATO on tax sharing agreements?

The Tax Office's advice is contained in Chapter 35 of the *ATO Receivables Policy* and this manual.

However **the Tax Office cannot provide legal advice or a ruling on this topic** and you may need to consult your legal and accounting advisers in preparing a TSA.

2. Can more than one TSA cover the same entire group liability?

No. A head company cannot enter into multiple TSAs with its subsidiaries in relation to one specific group liability. That is, only one TSA can exist for each group liability.

3. Can a TSA cover more than one entire group liability?

Yes. For example, it could cover all PAYG instalment liabilities for a year as well as the annual assessment liability.

4. Can a TSA cover more than one income tax year?

Yes, but the TSA will need to address any subsidiary members leaving the group or new members joining.

5. If a TSA covering two or more liability periods is changed between the due times for those periods, do all versions of the TSA need to be kept?

Yes. The versions that would need to be kept are those in place immediately before the time that *each* liability became due and payable, as they would be the relevant versions for Division 721. Any relevant deeds of assumption (or similar) would also need to be retained.

Draft versions do not need to be retained.

6. Can a head company of a consolidated group have a TSA with only one of its subsidiaries?

Yes, the head company can have a TSA with only one of its subsidiaries provided that:

- the allocation of the group liability to the TSA contributing member is a reasonable one, and
- the TSA covers **the entire group liability.**

7. Are all subsidiary members required to be parties to the TSA?

No. There is no requirement that all subsidiary members must be party to a TSA. The methodology on which the TSA is based may determine who should subscribe to it. For example, if the TSA is based on an accounting profit methodology, it would be prudent for all members to be party to it

→ 'Tax sharing agreement based on percentage of profit methodology, C9-7-510.

Consideration should also be given to due diligence factors such as whether a potential purchaser of a group company would require that the company be covered by a TSA.

8. Are there any guidelines covering what the Tax Office considers to be a 'reasonable allocation'?

Chapter 35 of the *ATO Receivables Policy* provides examples of what the Commissioner would consider to be a reasonably based allocation. The examples are not intended to be prescriptive nor exhaustive. Some example methodologies are also shown under 'Reasonable allocation' in this section → p. 5.

9. Are there any proformas setting out what the Tax Office expects a TSA to contain?

No. There are no proformas available as the Tax Office does not want to constrain consolidated groups in drawing up TSAs.

10. Will the Tax Office provide any guidance on the content of a TSA?

Yes. The minimum requirements for a valid TSA are specified in chapter 35 of the *ATO Receivables Policy*. The requirements are also set out under in this section → 'Valid tax sharing agreements' p. 2.

11. Can a TSA include other material such as arrangements for the ongoing funding of the group's tax liabilities, subvention payments etc.

Yes, provided they do not invalidate the TSA itself. However, as there may be conceptual differences between the TSA methodology and the methodology for ongoing funding arrangements (often called tax funding arrangements), you should consult your advisers about whether separate agreements are preferable.

12. Does a TSA executed after the head company's due time prevent the TSA contributing members becoming jointly and severally liable for the group's debt?

No. The TSA contributing members in such an event would remain jointly and severally liable. → 'Valid tax sharing agreements', p. 2

13. When would the Commissioner issue a notice under subsection 721-25(3) requiring a head company to provide a copy of a TSA?

Generally, the Commissioner would not issue such a notice until after the head company's due time. Even then, such a notice would not automatically be issued – it would depend on the reasons for non-payment. → 'Formal notice requesting a copy of a TSA', p. 5.

14. Chapter 35 of the *ATO Receivables Policy* refers to a schedule being provided to the Commissioner with the TSA showing the liabilities of each member. Does this schedule need to be in place before the head company due time?

No. The schedule is part of the 'approved form' requirements → section 388-50, schedule 1, *Taxation Administration Act 1953*. While the TSA itself needs to be in place before the head company's due time, the schedule only needs to be in place in time for it to be produced to the Commissioner if requested.

However care should be exercised in this regard. It is quite probable that the Commissioner's request for the TSA and schedule will be made after some of the relevant companies have left the group. It may not be convenient to access relevant accounting records of the former subsidiary members in order to complete the schedule. (The question of the group's access to the records of former members should be considered at the time of sale. Access may be needed for the purposes of the TSA and Part IVC objections.)

15. Can a member leave a consolidated group clear of a specific group liability?

Yes, provided that:

- it ceased to be a member of the group on or before the liability's due date, and
- before the leaving time it had paid to the head company an amount equal to either the contribution amount or (if that amount could not be determined) a reasonable estimate of that amount.

For more information see 'Clear exit' → p. 6.

16. If a new member joins the group or a member leaves the group, should a new TSA be drawn up?

In these instances, the group should review its TSAs as the exit or entry of members may affect the reasonableness of existing TSAs.

17. Should the head company send the Tax Office a copy of each new TSA when it is executed?

No. Although the Commissioner may require the head company to produce a copy of the group's TSA at or after the head company's due time, unless the head company defaults on its obligation to pay the group liability subject to the TSA, it is unlikely that it would need to be produced.

It would not be feasible for the Tax Office to review all TSAs as they are compiled. See chapter 35 of the *ATO Receivables Policy* for more detailed information.

18. Can a TSA contributing member provide the Commissioner with a copy of a TSA if it appears that the head company will fail to do so?

The notice to provide the TSA is issued to the head company, whose responsibility it is to provide the TSA. The head company is most likely to have the most current, valid version of the TSA. Should the head company decide not to provide the requested TSA, this is an issue between the head company and the TSA contributing members. See chapter 35 of the *ATO Receivables Policy*.

The exception to this is where a contributing member has achieved a clear exit pursuant to section 721-35, and has provided the Commissioner with a copy of the TSA within 14 days of the Commissioner giving the contributing member a notice of its joint and several liability, following the failure by the head company to provide a copy of the TSA to the Commissioner.

19. Certain entities are excluded by sub-section 721-15(2) from becoming jointly and severally liable. Which entities are these?

Sub-section 721-15(2) of the ITAA 1997 is intended to cover certain entities covered by the prudential requirements of the Australian Prudential Regulatory Authority (APRA). → Taxation Ruling TR 2004/12

References

Income Tax Assessment Act 1997, Division 721; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1, *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 14, and *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2, Part 10

Explanatory Memorandum to New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraph 11.12, diagram 11.1

Taxation Administration Act 1953, subsection 265-45(2)

The Tax Office has published guidelines for TSAs in the *ATO Receivables Policy,* available on the Legal Database page of its website, **www.ato.gov.au**

Taxation Ruling TR 2004/12 – Income tax: whether the exclusion under subsection 721-15(2) of the *Income Tax Assessment Act 1997* can extend to a participant in a licensed financial market or licensed clearing and settlement facility

Revision history

Section C9-7-110 first published 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
23.4.04	Inclusion of FAQs.	For clarification.
14.7.04	Note on recent changes to consolidation rules.	Legislative amendments.
26.10.05	Extensive changes.	Legislative amendments.
15.11.06	Changes to requirements for TSAs, pp. 3, 6.	Changes to practice statement.
30.6.09	Changes to note on due and payable date, p. 6, and text on amended liabilities under 'Clear exit', p. 7.	To align with changes to *ATO Receivables Policy*.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- **http://assistant.treasurer.gov.au** (Assistant Treasurer's press releases)
- **www.treasury.gov.au** (Treasury papers on refinements to the consolidation regime).

043 CRMUR Scanlan TSA insert Q and A

103 CRMUR Mark Cinsert alerts Karen C

129 CRMUR - Tax liabilities - Lian-Chin T

148 CRMUR - ATO Receivables align - 03