Sladen Legal

Collection of a Consolidated Group's Tax Liabilities

On 7 November 2013 the ATO released a Practice Statement (Practice Statement Law Administration 2013/5 (**PS LA 2013/5**)) which details the Commissioner's policy (previously included in Chapter 35 of the ATO's Receivables Policy) in relation to:

1. the collection of group liabilities from the Head Company, member entities and entities that have exited a Consolidated Group;

2. Tax Sharing Agreements (**TSAs**); and

3. the requirements for a member entity to make a "clear exit" from the Group.

PS LA 2013/5 can be accessed at:

http://law.ato.gov.au/atolaw/view.htm?docid=%22PSR%2FPS20135%2FNAT%2FATO%2F00001%22

PS LA 2013/5 confirms that:

- A head company is required to pay or otherwise discharge a group liability in full by the head company's due time. If the head company fails to do so, all entities that were members of the group for part of the liability period (the contributing members) become jointly and severally liable for that group liability, unless that liability is covered by a TSA.

- A contributing member's joint and several liability becomes due and payable 14 days after the Commissioner gives written notice to that entity. The Commissioner may provide this notice to one or more contributing entities, depending on the potential for recovery from those members. Once the full amount of the group liability and any related general interest charge has been collected, the Commissioner will cease recovery action against all contributing members in respect of that liability.

- The risk of joint and several liability is avoided if:
  - the group liability is covered by a valid TSA that reasonably allocated the liability amongst the parties; and
  - the TSA is produced when requested by the Commissioner.

- A TSA should be periodically reviewed to ensure its continued relevance and validity.

- Where a group liability is covered by a TSA, a contributing member may have no liability or be liable for only a portion of the group debt.

- An entity that leaves a consolidated group can exit clear of a group liability that has not become due and payable if, before the time it ceases to be a member of the group (the leaving time), it pays the head company the amount, or a reasonable estimate of that amount that would otherwise be payable under the TSA. The exited entity remains exposed to group liabilities that are due and payable by the head company prior to the exit.

- The minimum requirements for a TSA to be in the 'approved form' specified by the

Commissioner are that the 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 that liability or those group 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 (that is, the TSA contributing members);
- either:
    i. specify the exact contribution amount for each TSA contributing member for the relevant liability, or
    ii. if and when required to be produced to the Commissioner, include a schedule signed by the head company:
        - specifying the relevant liability or liabilities and period/s as specified in the Commissioner's notice to produce;
        - stating the name and ABN or ACN of the head company and each TSA contributing member;
        - stating the contribution amount of each TSA contributing member in respect of that liability or each of the liabilities; and
        - declaring 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*'; and
        - 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.

- Directors of member entities should:
    - consider their statutory and common law responsibilities as directors of the entity when becoming a party to a TSA and any obligation to the head company and/or the Commissioner that may result from them entering into the agreement;
    - resolve the content of the document and finalise arrangements to pay the head company's group liability by the due time;
    - seek legal and accounting advice in relation to all aspects of Division 721 of the ITAA 1997; and
    - establish appropriate processes to manage any tax risks.

An appropriately drafted and executed TSA, although not a requirement under the legislation, can therefore assist directors in managing tax risks as:

- it would provide a mechanism for reasonably allocating group liability amongst the contributing entities;
- it would provide for the entry and exit of members to and from the consolidated group so as to ensure that when members join a consolidated group, the head company's and the new member's obligations are appropriately documented; and
- when a member leaves the consolidated group, it obtains a 'clear exit' from income tax liabilities that are not due and payable at the time of the exit - this is especially reassuring for

the third party purchaser of the shares in a subsidiary member of a consolidated group. Any exposure to group liabilities that are due and payable by the head company prior to the exit may be managed through appropriate tax indemnity clauses in the share sale agreement.

Additionally, by having a Tax Funding Agreement (TFA) (either separate or included with the TSA) would enable a group to include an internal funding arrangement to ensure that the Head Company can fund the consolidated group's tax liability payments by members funding their proportion of the liability.

Member entities of a tax consolidated group should seek appropriate professional advice in relation to the legislative provisions governing the group's taxation liabilities and the preparation, review and execution of a TSA and TFA.

As PS LA 2013/5 states it relates to "events that will generate relatively complex legal obligations between subsidiary members and impact on creditors, financiers... prospective purchasers of group companies and third parties" and strongly suggests that "appropriate professional advice be sought on these matters".

For further information on TSAs and TFAs or how Sladen Legal can assist you or your clients with tax consolidation matters, please contact:

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