

Greenwoods & Freehills

Tax Brief

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Indirect Tax Sharing Agreements

From 1 July 2010, indirect tax sharing agreements (**ITSAs**) will become part of the GST landscape. Under the proposed measures, GST group members and participants in an approved GST joint venture can limit their indirect tax liability by entering into an ITSA with the representative member / joint venture operator similar to the effect that tax sharing agreements (**TSAs**) have for consolidated groups under Division 721 of the *Income Tax Assessment Act 1997*.

Limiting joint and several liability

Under current law participants in a GST joint venture and GST group members (**Members**), respectively, are jointly and severally liable to pay any amount payable under an indirect tax law by the joint venture operator / representative member (**Representative**).

On 22 January 2010, Treasury released Exposure Draft legislation outlining the rules relating to ITSAs which can limit the joint and several liability. The Exposure Draft also proposed changes allowing members of a GST group to join and leave a group during a tax period. Those measures were included in *Tax Laws Amendment (2010 GST Administration Measures No. 2) Bill 2010 (ITSA Bill)* introduced into Parliament on 18 March 2010.

The proposed ITSA measures apply to GST groups and GST joint ventures. ITSAs apply to all amounts payable under an indirect tax law which include GST, fuel tax, luxury car tax and wine equalisation tax.

Main effects of an ITSA

There are two main effects of an ITSA. If a valid ITSA has been entered into before an amount for a tax period (eg a calendar month) becomes payable and procedural and other requirements are met, then:

1. the joint and several liability of a Member for the indirect tax payable by the Representative is limited to its "contribution amount" for the tax period; and
2. a Member can achieve a "clear exit" for the tax period in which it leaves a GST group or GST joint venture provided it makes a payment to the Representative.

The ITSA does not, however, relieve the Representative of its liability for the full indirect tax amount of the group or joint venture.

The ITSA measures are proposed to have prospective application only – applying from 1 July 2010. Therefore, any liabilities for tax periods prior to that date will not be capable of inclusion in an ITSA.

Requirements of an ITSA

The formal requirements for a valid ITSA are:

1. it must have at least the Representative and relevant Member as parties;
2. an amount must be able to be determined under the ITSA for each Member that is a party to it (**Contributing Member**) in respect of the tax period;
3. the Contribution Amount for each Contributing Member for the tax period (**Contribution Amount**) must represent a “reasonable allocation” of the Representative’s total liabilities;
4. the ITSA must be in the “approved form” (usually requiring it to be in writing and properly executed – the ATO will likely provide guidance on what is required).

Generally speaking, the key ITSA issue for most taxpayers will be the requirement that the contribution amounts specified for each Contributing Member must represent a “reasonable allocation” of the Representative’s total liability. The Explanatory Memorandum to the ITSA Bill notes that the Commissioner will publish guidelines regarding what is a reasonable allocation. For TSAs under income tax law, these are currently set out in Chapter 35 of ATO’s Receivables Policy (along with the formal requirements for a TSA) and include allocations based on:

- use of historical information (eg average contribution to group profit);
- accounting profit;
- ability to pay (shareholder equity in each Contributing Member); and
- actual/expected contribution to group liability (i.e. determine notional tax liability on standalone basis).

It is likely that the ATO guidelines for indirect taxes will be different given the different nature of the taxes. The Explanatory Memorandum makes clear that it will not be necessary to allocate specific amounts of each indirect tax to each Contributing Member, although a total amount must be allocated and the allocation can be done for each tax if the group or joint venture so wishes.

In addition to the formal requirements for ITSAs, there are further requirements to be met in order for an ITSA to be effective, namely:

1. it cannot have been entered into as part of arrangement that had the purpose of prejudicing the Commissioner's ability to recover an amount payable under the law;
2. the Representative must give a copy of the ITSA to the Commissioner within 14 days of a written request; and
3. the Representative cannot be party to two or more ITSAs relating to same tax period.

The last two of these will require careful record keeping by groups and joint ventures of their ITSAs as they evolve over time with new members joining or leaving the group. This is necessary to ensure that two agreements are not in existence at the same time and to produce the correct version of the ITSA to the ATO for a relevant tax period on request.

For the "leaving period" clear exit, the Contributing Member must have paid the Representative its Contribution Amount (actual or, if that cannot be determined, a reasonable estimate) before the day the relevant GST return is due. We note that these requirements directly reflect the TSA provisions.

Main issues to consider

(a) Which Members should be a party?

One of the first issues to consider is which Members of the GST group or joint venture should be party to an ITSA? Similar to TSAs, all Members are likely to need to be party to an ITSA in order to ensure a "reasonable allocation" of the full liability. In any event, as the purpose of an ITSA is to limit the liability of Contributing Members, we would expect most Members of a GST group or joint venture would be a party to an ITSA; otherwise they would remain jointly and severally liable for the Representative's liabilities.

(b) What is a reasonable allocation?

As noted above, perhaps the main issue with ITSAs is likely to be what is a "reasonable allocation" of the Representative's liability? Any method needs to be able to calculate a specific amount for each Contributing Member for any tax period. This will be more difficult to determine / calculate for GST groups whose members make input taxed supplies. For example, it may be necessary to consider:

- the appropriate treatment of Contributing Members that are in a net refund position;
- how the (input taxed) activities of some Contributing Members can impact the GST recovery of other Contributing Members;
- the allocation of subsequent BAS revisions, amendments or refunds; and
- the impact of any retrospective grouping.

(c) Unresolved issue

ITSAs are currently only proposed to apply to GST groups and joint ventures. We have lobbied to ensure they also apply to partnerships where joint and several liability also exists. Whether this is necessary for tax law partnerships may depend on the outcome of Treasury's current review of whether to treat tax law partnerships as separate "entities" for GST purposes (as discussed in Treasury's Second Consultation Paper in relation to the Board of Tax Review of GST administration).

Differences between ITSAs and TSAs

Although there are similarities between TSAs and ITSAs (which may be useful in drafting and interpreting ITSAs), it is important to be aware of the differences between the two concepts. For example:

- there are differences in the language and content of the respective provisions;
- TSAs can cover the allocation of penalties and GIC as these are specifically identified as a "tax related liability" of the head company. However, penalties and GIC do not need to be covered under an ITSA as they are not "amounts payable under an indirect tax law by the [joint venture operator / representative member]"; and
- the clear exit provisions do not protect the former Contributing Member from all future liability as the former Member remains liable for any adjustment events occurring after exit which relate to supplies or acquisitions of the former Member while in the group or joint venture. It is clear from the Explanatory Memorandum that this outcome is intended. Hence a purchaser of the former Member will need to address this issue in doing its due diligence.

Should my organisation enter into an ITSA?

The most common question we are hearing about ITSAs is: *Should my organisation have one?*

ITSAs are not critical to the day-to-day GST operations of a business but are necessary if businesses wish to limit indirect tax liabilities of their Members. Given the take up of TSAs, we expect most large corporates will enter into ITSAs.

There are a number of specific circumstances where we envisage ITSAs will be relevant or desirable. These include:

- *Securitisation arrangements* – we note that ratings agencies have previously had concerns regarding securitisation SPVs being included in GST groups as a result of the joint and several liability.

- *GST joint ventures* – ITSAs will be desirable for GST joint ventures as the parties are usually unrelated and not otherwise jointly and severally liable for each other's liabilities.
- *Requirements of financiers* – banks may start requiring ITSAs when lending to specific entities so as to ensure the borrower is not “on the hook” for other group member's liabilities.
- *Purchasers in M&A deals* – purchasers of specific entities within a corporate group may now insist upon those entities having ITSAs to limit their potential exposure to past liabilities.
- *Non-residents* – non-residents that are Members of a GST group or GST joint venture are likely to want to sign up to an ITSA as they would not want to be involved in the complexities (e.g. transfer pricing/deductibility issues) and time consuming processes of the ATO trying to pursue them for the Representative's liabilities in the event of default.

Similar to TSAs, we anticipate that ITSAs will require some initial preparatory work to put the arrangements in place but should be relatively easy to administer on a go forward basis.

GST groups and joint ventures may already have in place separate funding agreements to ensure that the Representative is put in funds to pay GST on time. These agreements should be kept separate from the ITSA and reviewed for ongoing appropriateness when an ITSA is entered into.

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These notes are in summary form designed to alert clients to tax developments of general interest. They are not comprehensive, they are not offered as advice and should not be used to formulate business or other fiscal decisions.

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