Tax consolidations 101

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Qualification

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- Reason for presentation
- Complex, but presentation looks to provide an overview
- Mainly targeted towards simpler scenarios

What is tax consolidation?

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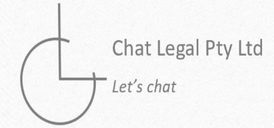
- Regime under Part 3-90 *Income Tax Assessment Act 1997*
- Whereby certain entities are treated as a single entity for income tax purposes
- Also available for GST – Part 4-1 *A New Tax System (Goods and Services Tax) Act 1999*
- Also appreciate the GST Act considers the effect of the income tax consolidation act in terms of 'supplies'

What is the effect of tax consolidation



- If a group of entities are treated as a single entity for income tax purposes:
  - One tax return
  - Transactions between all those entities are disregarded from a tax perspective
  - All entities are potentially liable for tax debts
- The 'single entity' is the holding company
- Meaning the holding company's name is used for the tax returns and the first point of call
- Being treated as a single entity means all historical tax effects should be adjusted accordingly
- Tax consolidation is irrevocable and automatically apples to all whole-owned Australian entities in the group

Why tax consolidate

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- Simply tax affairs for the broader group – one tax return and one franking account
- No need to consider tax treatment between intra-group entities
- Ability to utilise tax losses throughout the group * (subject to rules being satisfied)
- Undertaking tax effective restructures
- Moral feeling that it is a group of entities

Who might tax consolidate

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- Businesses with multiple wholly owned subsidiaries
  - Beneficial if some subsidiaries in loss positions
- Businesses with separate entities holding different aspects of the business and there are intra-group arrangements (i.e. one subsidiary licencing IP to the trading subsidiary)

- Businesses unable to appreciate the complexity should not consolidate

Who can be part of a tax consolidation

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- Head entity must be a company* (although certain corporate unit trusts and public trading trusts or corporate limited partnerships may be substituted)
- There are other requirements such as needing to be an Australian resident
- There must be at least one subsidiary to commence the group
- Group continues so long head company exists
- Subsidiaries must be wholly-owned by the head company in addition to other requirements such as not being a non-profit company
- Subsidiaries can also be a trust or partnership
- When considering the beneficial owner, consideration is made as to the owner of the property in equity

How is tax consolidation formed?

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- ATO form completed
- If various entities in existence, then a calculation has to be run to effective apportion the assets in the subsidiary between the head entity and the subsidiary for tax purposes
- This calculation is often called 'running ACA's
- The rationale behind this relates to the fact that a consolidated group treats all entities as one entity (the head entity). As a result, any existing tax assets in a subsidiary effectively needs to be revalued as if it were held by the head entity. This will consider various things such as liabilities, undistributed profits, losses and tax deductions that can warp the calculations)
- On entry or exit of each subsidiary, calculations need to be rerun.

A single entity

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- Does not prevent individual subsidiaries having a valid legal agreement with third parties or intra-group
- Only means no tax treatment between the intra-group entities
- Does not mean there is no asset protection to segregate business divisions as each entity is still legally a separate entity
- Thought still needs to be made in relation to other taxes such as GST and stamp duty
- Being a single entity, all group members will be liable to tax debts
- Steps could be taken to have a Tax Sharing Agreement and/or Tax Funding Agreement to set out how liabilities are to be shared

The best time to consolidate

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- Ideally at the start
- Next best provided no assets in subsidiaries that would require extensive 'ACA' calculations being run
- Tricks available through concessions and rollovers to get into a tax consolidated group

Losses and tax consolidations

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- Pre-consolidation losses needs to be reapportioned, and it is likely you can lose some losses when bring it into the group
- Tests also need to be run before the losses can move into the group – using modified continuity of ownership and/or same business tests
- Once losses are in the group, then additional tests need to be run prior to utilising the losses

ACAs

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- Creating a consolidated group means the head company having tax values reassessed
- This is because each subsidiary will have its assets be considered as part of the head company
- Therefore a cost needs to be allocated to the asset of the subsidiary to be held by the head company (on leaving the group, the cost is reversed)
- Market valuations need to be obtained for the subsidiary assets, including for off balance sheet and intangible assets such as goodwill

ACA process

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- Determine 'allocable cost amount' for subsidiary joining
- Apportion part of the allocable cost amount to subsidiary member's **retained cost base assets**
- Apportion the balance of the allocable cost amount to the subsidiary member's **reset cost base assets in proportion to their market values**
- Section 705-60 *Income Tax Assessment Act 1997* shows the 8 steps to determine what the 'allocable cost amount' is

Consolidating quirks

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- Pre-CGT status maintained after consolidation (as part of the regime is to ensure no tax consequences result from consolidating – note not the same as tax cost being reset)
- Only head company maintains a franking account
- Part IVA on consolidation – i.e. dominant purpose of entering into arrangement is to obtain a tax benefit, being the ability for the head company to access tax losses of subsidiary members

Administrative rules

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- Head company first instance liable, but all other group members jointly and severally liable if head company fails to meet
- Note on tax funding agreement and tax sharing agreement
- A valid tax sharing agreement requires:
  - Agreement to exist before liability is due and payable
  - A determination of the contribution amount
  - The contribution amount for each contributing member to be reasonable allocated (i.e. can't shift all the liability with the high risk entity to protect the low risk high asset subsidiary)
  - The agreement not to be entered into to prejudice recovery of the liability
- Agreement also needs to be produced if asked

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