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Section 100A Recent cases, guidance and what to do this 30 June – March 2022

With:
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Overview

- Today is a discussion
- Assumed basics are understood
- Focussing on ATO comments in recent guidelines
- Is it fair?

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The basics – section 100A

- Beneficiary has a present entitlement
- Present entitlement arose under a *reimbursement agreement*
- Benefit is provided to someone other than the beneficiary
- Agreement is not entered into in the *course of ordinary family or commercial dealing*
- Entered into for a purpose of reducing income tax

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The basic example – section 100A

- Low Income Adult Child has present entitlement to trust income
- Money never distributed to Low Income Adult Child but rather trust lends to High Income Parent
- Low Income Adult Child either forgives or assigns amount at a later date
- Okay/Not okay?

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What came out?

- TR 2022/D1 – Income tax: section 100A reimbursement agreements
- PCG 2022/D1 – Section 100A reimbursement agreements: ATO compliance approach
- TA 2022/1 – Parents benefitting from trust entitlement of their children over 18 years of age
- TD 2022/D1 – Income tax: Division 7A: when will an UPE or amount held on sub-trust become the provision of 'financial accommodation' (not covered but note relevant for corporate beneficiaries)

TR 2022/D1

- Paragraph 4: Note: At the time of the release of this draft Ruling[3], the decision of the Federal Court in Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation [2021] FCA 1619 (Guardian), referred to in this Ruling, is the subject of an appeal.

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TR 2022/D1 - Agreement

- Paragraph 7: An 'agreement' is defined widely for section 100A to include arrangements and understandings.[7] Those terms have their ordinary and legal meaning in the context in which they appear. An agreement can be informal, express or implied, and need not be enforceable or intended to be enforceable. An agreement may be inferred from the surrounding circumstances or the conduct of the parties

TR 2022/D1 – Relevant connection

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- Paragraph 11: The amount the taxpayer would have been made entitled to (or have been paid or had applied for their benefit) absent the reimbursement agreement (or absent the relevant act, transaction or circumstance occurring in connection with the reimbursement agreement) involves a prediction as to events which would have otherwise taken place. **The prediction must be sufficiently reliable for it to be regarded as reasonable.**
- Paragraph 12: For an entitlement to arise from (or payment or application to result from) a reimbursement agreement, that agreement must have been in existence prior to the entitlement arising (or before the resulting payment or application of income). However:
  - **conduct of the parties before and after that time may be relevant to establishing the existence of an agreement at that time, and**
  - **neither the presently entitled beneficiary nor the trustee needs to necessarily be a party to the agreement or even in existence when the agreement is made.**

TR 2022/D1 – Benefits

- Paragraph 15: Despite the label given to 'reimbursement agreements', the payment of money to, transfer of property to or provision of services or other benefits for a person other than the beneficiary alone need not necessarily be a 'reimbursement' as such to meet the requirements of subsection 100A(7). In particular, there is no requirement that the relevant money, property, services or other benefits provided to a person other than the beneficiary alone, be sourced from, equal to or otherwise be referrable to the share of trust income the beneficiary is presently entitled to receive, was paid or that was applied on their behalf.

TR 2022/D1 – Tax reduction

- Paragraph 17: A tax reduction purpose includes a purpose of deferring a party's tax to a later income year.
- Paragraph 19. Where a party acts in accordance with advice from an adviser, the purpose of that adviser can be imputed to the party.

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TR 2022/D1 – Ordinary dealing

- Paragraph 20: Agreements 'entered into in the course of ordinary family or commercial dealing' are not reimbursement agreements for the purposes of section 100A.[11]
- Paragraph 21: 'Ordinary family or commercial dealing' is a composite phrase that is undefined, and takes its meaning in the context where it appears in section 100A. **The test is an evaluative standard to be applied to the facts of each case.**
- Paragraph 22: The essential feature of ordinary family or commercial dealing is that it is ordinary. **Acts undertaken in the course of ordinary family or commercial dealing are capable of explanation by the familial and/or commercial objects they are apt to achieve**.
- Paragraph 23: **A dealing is not an ordinary family or commercial dealing merely because it is commonplace or involves no artificiality**.

TR 2022/D1 – Familial

- **Paragraph 25**: Whether the agreement was entered into in the course of ordinary dealing is an **objective enquiry** to be addressed, at least principally, from the perspective (and in the context) of the persons whose purposes are relevant to the operation of section 100A.
- **Paragraph 27**: The ordinary dealing exception does not apply simply because all parties to an agreement are family members. To be in the course of ordinary dealing, **the transactions between family members and their entities must be capable of explanation as achieving normal or regular familial or commercial ends**

TR 2022/D1 – Other

- Paragraph 41. Unlike the general anti-avoidance provisions in Part IVA, **section 100A does not require the making of a determination by the Commissioner[12]; it is a self-executing provision which operates according to its terms**.
- Paragraph 58:
  - An **'arrangement' could be informal** concerted action by which two or more parties may arrange their affairs towards a purpose.[30] An example in the particular context of section 100A would be an 'arrangement or understanding' that the beneficiary would act in accordance with the wishes of another person or group.
- Paragraph 64: **The taxpayer has the onus of establishing a reasonable expectation that the beneficiary would have been presently entitled to the original amount if the reimbursement agreement had not been entered into**.[35] A 'reasonable expectation' requires more than a possibility. It involves a prediction as to events which would have taken place if the reimbursement agreement had not been entered into. The prediction must be sufficiently reliable for it to be regarded as 'reasonable'.[36]

TR 2022/D1 – Other

- Paragraph 81. **The dealing to be tested is identified by reference to the subject matter and terms of the agreement; that is, the transaction, set of transactions or other actions which implement and give effect to the agreement. In order to engage the exception, it is these transactions or other actions which must have the quality of ordinary dealing**.[49]
- Paragraph 82. The whole course of dealing contemplated by the agreement must be examined. For example, the sale of a business between related entities may of itself be ordinary dealing. However, the sale may be one element of a larger transaction or series of transactions contemplated by the agreement. The larger transaction or other steps in the transaction may be very different from a straightforward business sale and not be ordinary dealing.[50]

TR 2022/D1 – Other

- Paragraph 83. While the dealing to be tested is the conduct of the transaction, set of transactions or other actions to give effect to the agreement, **contextual facts and circumstances are highly relevant**. Context may inform the commercial and family objectives of an agreement. These may include, for example, **the relationship or association between the parties and their economic or other relevant circumstances**. For example, assume in an income year, family members agree to gift their trust distributions to one family member, **Paul, who has significant medical bills. The arrangement is implemented via trust distributions to the family members and a gift by each of them to Paul**. That Paul has significant medical bills is not a construct of the agreement; however, it is a highly relevant contextual fact which bears on what are familial objectives. **In this context, there is nothing extraordinary about the arrangement or the transactions (trust distributions and gifts) which give effect to the agreement.**
- Paragraph 84. The application of the ordinary dealing exception can raise questions about how to assess the achievement of familial or commercial objects or the presence of tax-driven elements in a dealing, and the relevance of the operation of other tax laws.

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TR 2022/D1 – Other

- Paragraph 87: **To explain** that acts achieve **familial objects** without the need for further explanation, **a person** would need to **objectively conclude that the transactions entered into among family members** (including via their entities) are **adopted as a means to achieve normal or regular familial ends**. The characteristics of the dealing, including the circumstances of the parties, the economic and other results of the dealing, and the type of relationship between the parties will be relevant. For example, a dependent child gifting money attributable to a family trust distribution to their parents who could otherwise have been made presently entitled to the trust income would in most cases not have the quality of ordinary dealing.

TR 2022/D1 – Other

- **Paragraph 89**. The dealing must be capable of explanation as being for the advancement of normal or regular familial objects. This objective enquiry can accommodate extraordinary or unusual features that apply to a particular family. **However, the test is not of what is common practice for either a family or for the community**.[52] For example, an arrangement between family members where the overt acts achieve **a particular favourable tax result will not be ordinary dealing simply because the arrangement has become prevalent, unless it can otherwise be seen to result in the achievement of a familial or commercial object**.

- **Paragraph 90**. For a dealing to be capable of explanation as achieving ordinary commercial objects, **the parties would be expected to advance their respective interests**. It is ordinary commercial dealing where it would be normal or regular if seen in trade or commerce as a means to advance commercial objects. A complex commercial dealing may nonetheless be 'ordinary' if that complexity is needed to achieve the identified commercial objects.[53]

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TR 2022/D1 – Other

- Paragraph 94. In the context of section 100A, an income tax anti-avoidance provision, a commercial or familial object of reducing collective income tax liabilities to maximise post-tax group wealth, would not of itself satisfy the ordinary dealing exception. For example, a trustee making a lower-taxed beneficiary presently entitled to trust income while paying the underlying funds to another person or persons who would otherwise pay higher tax, will not be an agreement entered into in the course of ordinary dealing solely because it can be explained as increasing collective post-tax family or group wealth.

TR 2022/D1 – Other

- Paragraph 95 notes the following as less likely to be an ordinary dealing:
  - There is conduct or circumstances inconsistent with the legal or economic consequences of the beneficiary's entitlement; for example
  - it appears unlikely that beneficiaries will ultimately receive their trust entitlements, which may occur when
    - assets or funds representing the entitlement are purportedly lent to others without any intention of being returned or repaid
    - funds representing the entitlement are invested in ways inconsistent with that entitlement, or
    - funds representing the entitlement are dealt with in a way that is inconsistent with the beneficiary's right to demand the entitlement
  - beneficiaries are not compensated for being kept 'out of the money' (for example, by way of interest, although noting that loans without interest may, depending on the cultural and other familial circumstances, qualify as ordinary dealing)
  - beneficiaries are not informed of their entitlements
  - where income entitlements have actually been remitted to the beneficiary, amounts were subsequently returned or other benefits or services were provided, by way of gift or otherwise to another person (such as the trustee, another beneficiary or an associate, whether by the beneficiary or by the trustee either independently or under a power of attorney), and
  - income entitlements have not been remitted to the beneficiary, and the reasons given are false having regard to the reasons given for the purported distribution.

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TR 2022/D1 – Example 2

- Example 2 - distribution to spouses with mixed finances
- 110. The Rosegum Family Trust is controlled by spouses, Lisa and Matthew Rosegum, who are the primary beneficiaries of the trust. The trust has a widely-drawn objects clause which includes family members of Lisa and Matthew and their related entities.
- 111. Each year, the trust makes Lisa and Matthew presently entitled to the income of the trust in equal proportions.
- 112. Lisa and Matthew have shared financial responsibilities and fund their lifestyle from a common pool of assets.
- 113. Trust distributions to spouses who have shared financial responsibilities and who ultimately enjoy the shared benefits of the distribution would usually be capable of explanation as achieving ordinary familial objects without the need for further explanation. Absent any additional factors taking the arrangement beyond those ordinarily encountered in the organisation of financial affairs between spouses, the arrangement would likely be entered into in the course of ordinary dealing.

TR 2022/D1 – Example 3

- Example 3 - gift from parents to a child
- 114. Assume the same facts as Example 2 of this Ruling. In one year, Lisa and Matthew's eldest child, Kate, purchases a property. Lisa and Matthew pay for the deposit with funds attributable to their distribution from the Rosegum Family Trust. The making of gifts between family members for ordinary familial purposes, such as parents contributing to the purchase of a house, without additional facts, would usually be ordinary dealing, as able to be explained as achieving ordinary familial objects without the need for further explanation.
- 115. A different outcome might arise if, for example:
  - parents gift money received from a trust to their children repeatedly and the parent has a lower marginal tax rate and lesser means than the adult child who is also capable of benefitting under that trust in their own right (such as retired parents repeatedly gifting trust entitlements to higher marginal tax rate children in lieu of the trustee distributing to the adult child directly), or
  - the situation is reversed, so that Kate, who is less financially advanced, gifted money to Lisa and Matthew, particularly where the adult child has a lower marginal tax rate than the parent (see Example 4 of this Ruling).

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TR 2022/D1 – Example 4

- Example 4 - trust entitlement gifted to trustee
- 116. The trustee of the Gallagher Family Trust makes Pauline, who is an adult full-time student, presently entitled to trust income for a particular year. Pauline's entitlement is determined so her taxable income will not exceed certain marginal tax rate thresholds. Pauline gifts her entitlement back to the trustee.
- 117. The creation of an entitlement and gifting back indicates there may be an agreement, arrangement or understanding between the parties which is connected to Pauline's present entitlement. An arrangement between family members where the overt acts achieve a particular favourable tax result but cannot otherwise be seen to result in the achievement of any regular familial object will not be entered into in the course of ordinary dealing simply because it is among family members. For these reasons, the gifting back of Pauline's entitlement calls for explanation.
- 118. In circumstances where Pauline gifts her entitlement back to the trustee every year, it may be reasonable to infer that the dealing is not made for the furtherance of any familial or commercial object and was instead made for the reduction of tax. The dealing appears artificial, contrived and to involve the trustee and beneficiary acting cooperatively to achieve a particular tax outcome.

TR 2022/D1 – Example 4

- 119. The evidence may more closely exhibit tax avoidance where the arrangement is repeated in subsequent years. However, it would still be open depending on the facts to demonstrate that a reimbursement agreement existed at the time when Pauline's present entitlement arose in year one, or in the event that the arrangement did not continue after the first year.
- 120. Additional factors which may indicate the dealing more closely exhibits tax avoidance than ordinary dealing would include:
  - the trustee loaned funds attributable to Pauline's entitlement to her parents on interest-free terms for an undefined period, or
  - instead of gifting back to the trust, Pauline gifts her trust entitlements to her parents, or
  - instead of gifting back to the trust, Pauline applies her trust entitlements to repay her parents for costs incurred by them on her maintenance, education and financial support while Pauline was a minor.

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TR 2022/D1 – Other examples

- Example 5: UPE on separate trust which is fine if set aside. Different conclusion may occur where:
  - Funds loaned interest free for an undefined period of time to another person; or
  - Funds applied in a way inconsistent with being able to satisfy entitlements
- Example 6: Parents lending entitlement to child (even if interest free) is fine. Different conclusion if:
  - Lower marginal tax rate parents consistently lends to child interest free.
  - Child who is less financially advanced loans to parent
- Other examples include using UPE for share buyback and the 'washing machine approach'

PCG 2022/D1

- Zones and risk
- White: Low
- Green: Low
- Blue: Medium
- Red: High

PCG 2022/D1 – White zone

- Arrangement entered into before 1 July 2014
- Not currently being audited/tax returns for 2017 not yet lodged

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PCG 2022/D1 – Green zone

- No dedicated compliance resources if as follows
- Individual beneficiary made presently entitlement and amount is mixed with spouse funds or joint account for family purposes
- Beneficiary made presently entitled but funds retained by trustee where all the following are satisfied:
  - No 'dodgy' factors (see Blue Zone)
  - Beneficiary controls trust/employed in the business of the trust/valid Div 7A loan

  Accepted funds may need to be retained in trust as working capital or acquiring additional assets in the trust (will be deemed failed if funds are applied for benefit of an associate)

PCG 2022/D1 – Blue zone

- Medium risk
- Not green zone if retention of funds carry any of the following:
  - Arrangement is in red zone
  - Beneficiary gifts trust entitlement or amount receivable (such as where UPE converted to loan resulting in amount receivable)
  - Beneficiary disclaims entitlements, forgives or releases obligation to pay
  - Intentional discrepancy of distributable income from tax income
  - Beneficiary entitlement satisfied by same beneficiary sourcing funds:
    - Dividend paid to satisfy amount payable by the trust (e.g.)
  - Tax avoidance purposes

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PCG 2022/D1 – Red zone

- High risk
- Beneficiaries' entitlements motivated by sheltering trust's net income from higher rates of tax and level of contrived elements enabling someone other than the presently entitled beneficiary to have use and enjoyment of the economic benefits
- Examples:
  - Adult beneficiary presently entitled but funds representing entitlement paid to other person in connection with expenses incurred by that person before the beneficiary turned 18.
  - Same but funds are then gifted or lent to other person.
  - Where beneficiary is a non-resident, such amounts lent or gifted.
  - The 'washing machine' – involving a bucket company whose shares are held by the trust
  - Issuing of units to satisfy UPE
  - Net income included significantly more than money transferred

PCG 2022/D1 – Red zone

- Arrangements where presently entitled beneficiary has losses and each of the following applies:
  - A reasonable person would conclude that the beneficiary was made entitled so the beneficiary's deductions or capital losses could be utilised against the trust net income (including trust capital gains)
  - The economic benefit associated with that trust net income is utilised by the trustee or an entity other than the beneficiary
- An exception to this would include where the beneficiary's taxable income is less than the beneficiary's share of the trust net income due to a tax depreciation measure

PCG 2022/D1

- Consider going through examples

TA 2022/1

- Parents benefitting from the trust entitlements of their children over 18 years of age
- PCG considered where offsetting against under 18 expenses
- In this case:
  - Trust income to adult child
  - Parents exercise control and enjoyment of the economic benefit
  - Trust income appointed to child may be:
    - Paid to parents or dealt with by parents at their discretion
    - Applied to repay amounts 'owed' by them to their parents (such as amounts owed in respect of parental expenses)
- Common that:
  - No contemporaneous evidence regarding amounts owed by children
  - Children no aware of their entitlements

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TA 2022/1 – Examples

- Example 1: ATO has Issue
  - Parents do not pay $160,000 entitlement to the two children
  - Note parents already entitled to $200,000 each
  - Amount applied to pay down debt on family home owned by parents
- Example 2: ATO has Issue
  - Child agrees to apply distribute against secondary school fees which parent retained amounts paid
- Example 3: ATO has NO Issue
  - Child pays $10,000 board and $20,000 of university fees
  - Distribution of $40,000 to child but only $10,000 actually paid to child
  - Other $30,000 was to the parent who had previously met the university fee with $10,000 paid to grandmother's benefit

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Thoughts?

- Some ambiguity still with what is ordinary family dealing, but examples provides scenarios which are fine
- General rules
  - Do not hold pre-18 expenses against a child as something to be repaid via trust distribution post 18
  - Can pay for an adult child's expense if deemed reasonable (i.e. an adult child having parents to assist with payment of university fees)
  - If distributing to adult child, ensure such funds are distributed or be in a position for them to call on
  - Note the acceptance that funds can still be retained in the trust under certain circumstances
  - Take care if distributing to beneficiaries holding losses (how scandalous)

Smarter people than me

- Don't follow historical distributions blindly
- Consider PCG and staying in white or green zones
- Ensure contemporaneous evidence regarding the offset of any trust entitlements
- Paying distributions preferred
- Focussing on distributing for family provision rather than tax minimisation.

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