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ATO finalises views on trust distributions – section 100A

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20 December 2022

What we will cover

- 100A – what is it and why we care?
- The final ruling – what is different?
- The final PCG – what is different?
- What should you be doing about pre-2014, 2014-2022, 2023 and beyond?

100A – the provisions

- **For 100A to operate:**
  - beneficiary presently entitled to a share of the **income of the trust estate** (*read the deed*)
  - entitlement arose out of a "reimbursement agreement"
  - a tax minimisation purpose
  - not an ordinary family or commercial dealing

- **Reimbursement agreement?**
  - An "agreement" … that provides for the payment of money or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the beneficiary or the beneficiary and another person or other persons (s 100A(7))
  - Tax reduction purpose (s 100A(8))
  - Payment includes a loan (s 100A(10))

100A – the provisions

- **Requisite Connection**
  - Between entitlement and reimbursement agreement
  - Question is whether beneficiaries would have been entitled but for the reimbursement agreement
  - Onus is on taxpayer to show that they still would have been made entitled

- **"Agreement"?**
  - Covers arrangements broadly
  - Not arrangement entered into **<u>in the course of an ordinary family or commercial dealing</u>**

100A – the provisions

- **Increased amount**
  - Beneficiary gets more than they would have had the reimbursement agreement not existed

- **Consequences**
  - Trustee assessed under 99A
  - Self-assessment – compare with Part IVA
  - No period of review for trustee assessment
  - Beneficiary not presently entitled for tax purposes

100A – ATO position and case law

- In 2014 the ATO released a fact sheet
- In February 2022 the ATO released a draft ruling and practical compliance guideline
- In June 2022 the ATO provided website guidance
- In December 2022 the ATO finalised their ruling and practical compliance guideline
- *Guardian* [2021] FCA 1619, *Bblood* [2022] FCA 1112

TR 2022/4 – final ATO ruling

- Rewritten but not different

- Ordinary family or commercial dealing
  - *103. What is commonplace is not the test. An arrangement that is commonplace, but which does not achieve family or commercial objectives, is not entered into in the course of ordinary family or commercial dealing.*
  - Cultural practices

- Implications for streaming dividends or capital gains

PCG 2022/2 – finalised PCG

- Still color coded zones, but three not four, white, green, red - blue zone eliminated

- New green zone examples

- No changes to timing of views, pre-2014, 2014 – 2022, 2023 and beyond

PCG 2022/2 – finalised PCG

Risk level	Risk zone	Description and compliance approach
Low risk	White zone	The white zone applies to arrangements entered into in income years that ended prior to 1 July 2014. ATO will commence compliance activity if outside green zone and otherwise considering earlier years, or entered into arrangement that continues before and after 1 July 2014
Low risk	Green zone	The ATO will not dedicate compliance resources to consider the application of section 100A to arrangements in the green zone, other than to confirm that the features of the relevant scenario are present in your circumstances.
High risk	Red zone	In this zone will attract the ATO's attention and they will conduct further analysis on the facts and circumstances of your arrangement as a matter of priority. If further analysis confirms the facts and circumstances of your arrangement are high risk, the ATO may proceed to audit where appropriate.

PCG 2022/2 – finalised PCG

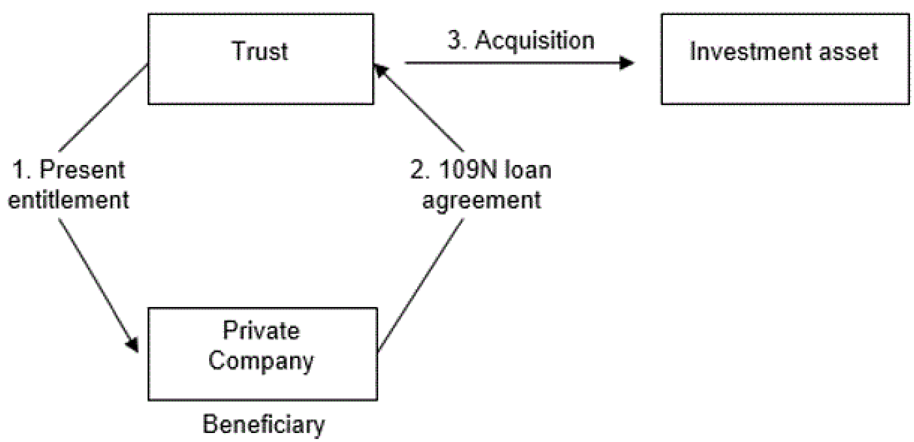
- New green zone example – scenario 2
  - Beneficiary receives entitlement within 2 years of becoming presently entitled and beneficiary uses the income
  - None of the paragraph 32 exclusions apply (there are many more than previously)

PCG 2022/2 – finalised PCG

- New green zone example – scenario 3A retention of funds for
  - working capital of a business that it actively carries on
  - the acquisition, maintenance or improvement of investment assets of the trust, or servicing of debt used to acquire, maintain or improve those assets
  - to lend the funds to another entity within the family group on commercial terms where the borrowing entity uses the funds in a way outlined above
- none of the paragraph 32 exclusions apply
- the beneficiary or their spouse (or both) is a trustee of the trust or controls the trustee of the trust, or the beneficiary is employed in the management of a business that the trustee conducts.

PCG 2022/2 – finalised PCG

- New green zone example – scenario 3B retention of funds for working capital
  - trustee or company beneficiary
  - beneficiary not exempt
  - beneficiary member of family group
  - none of the paragraph 32 exclusions apply
  - loan on commercial terms – Division 7A



PCG 2022/2 – finalised PCG

- Example 11 from PCG of use of funds and UPE
  - *During the 2023-24 income year and subsequent income years, Investment Pty Ltd uses trust receipts to meet its principal and interest obligations under the loan agreement.*
  - *Funds representing the beneficiaries' present entitlements that have been retained satisfy the use of funds condition and a written loan agreement has been entered into between Investment Pty Ltd and Beneficiary Pty Ltd on commercial terms. We would not dedicate compliance resources to this arrangement as it meets the conditions in Green zone: scenarios 3A and 3B of this Guideline and does not have any features that exclude it from the green zone under paragraph 32 of this Guideline.*

PCG 2022/2 – finalised PCG

- Paragraph 32 exclusions
  - The arrangement is a red-zone arrangement
    - Lending or gifting of entitlements – pre-18 and non-resident
    - Trust income returned as assessable income – washing machine
    - Unitisation arrangements
    - Difference between trust income and net income – deed amended, power used, or undertaking a transaction - there does not appear to be a deed amendment necessary
    - Loss beneficiary outside of family group
    - Taxpayer alert

PCG 2022/2 – finalised PCG

- Paragraph 32 exclusions
  - the beneficiary makes a gift of the funds received either in satisfaction of their trust entitlement or an associated amount paid by the trustee (for example, if the unpaid present entitlement (UPE) was converted into a loan) except where the gift meets the requirement of Green zone: scenario 1 – using funds for benefit of spouse and children
  - the beneficiary disclaims their entitlement or forgives or releases the trustee from its obligation to pay their trust entitlement or an associated amount receivable from the trust (for example, if the UPE was converted into a loan)
  - the beneficiary's entitlement is less than the beneficiary's share of net income, franked dividends of the trust and trust capital gains as a result of the trustee exercising a power, or the deed being amended or varied, to affect the quantum of income of the trust estate

PCG 2022/2 – finalised PCG

- Paragraph 32 exclusions
  - a beneficiary's trust entitlement is satisfied by payments that are sourced from that beneficiary, or a beneficiary's trust entitlement has been made subject to a loan agreement and the repayments of that loan are sourced from payments or loans from that beneficiary, e.g.
    - satisfies a corporate beneficiary's UPE or makes a loan repayment to that corporate beneficiary by way of set-off against a dividend paid by that corporate beneficiary
    - issues units in the trust to the beneficiary and the amount owed for the units is set-off against the amount payable by the trust to the beneficiary, or
    - satisfies a beneficiary's entitlement or satisfies a loan repayment to that corporate beneficiary by way of set-off against that trustee's entitlement to income of another trust that includes franked distributions paid by that corporate beneficiary

PCG 2022/2 – finalised PCG

- Paragraph 32 exclusions
  - NEW - the beneficiary is a loss company or loss trust that uses its trust entitlement to fund a distribution to its members and that distribution compromises the ability of the beneficiary to repay its existing or future liabilities
  - NEW - the beneficiary is a private company that uses its trust entitlement to fund a distribution that is made directly or indirectly to a non-resident
  - NEW - the beneficiary is a private company or trust that uses its trust entitlement to fund a distribution that is made directly or indirectly to the trustee that made the beneficiary presently entitled to income
  - NEW - the trustee has not notified the beneficiary of their entitlement to trust income by the earlier of the trustee's due date and actual date of lodgment

PCG 2022/2 – finalised PCG

- Paragraph 32 exclusions
  - NEW - where the beneficiary that is presently entitled to trust income in a year is required to lodge a tax return for that year, either the
    - beneficiary has not lodged, or
    - the beneficiary has understated or omitted in that tax return their share of the trust net income, trust capital gains or franked dividends received from the trust
  - NEW - the beneficiary uses the trust entitlement to pay excessive consideration where the parties are not dealing at arm's length.

PCG 2022/2 – finalised PCG

- Record keeping
  - the trust deed (including amendments), trustee resolutions and contact details of the trustee and former trustees
  - notes, contemporaneous documents and records of discussions or meetings explaining the transactions that have happened or calculations that have been made
  - details of how the beneficiary was notified of their present entitlement to trust income
  - details of how the present entitlement to trust income was satisfied and, where practical, used by the beneficiary
  - details of how the trustee utilised the underlying funds; for example, to satisfy the trustee retention of funds or the trustee working capital condition
  - copies of loan agreements and records showing how the loan repayments were satisfied from time to time.

Trustee duties

- Consider interaction between 100A and trustee duties around trust distributions

- Good faith upon real and genuine consideration?
  - *Karger v Paul*
  - *Marsella v Wareham*
  - *Re Owies Family Trust*

Some examples

Scenario	Risk and comments
Income distributed to adult child. The distribution is promptly paid into child's bank account and is used to fund the child's living expenses.	Low risk. No benefit to another person.
Income distributed to husband and wife. The distribution is paid out and on-lent, interest-free, to adult child to fund house deposit. The adult child is on a higher tax rate than his or her parents.	Low risk if this is a one off instance. Greater risk if it occurs regularly
Income distributed to the adult child. The trustee discharges part of the entitlement by paying the adult child's university fees.	Low risk as it is applied for the benefit of the adult child
Income is distributed to a grandparent. The distribution is paid into a bank account in the grandparent's name and is gifted or lent to their child who controls trust.	Medium to high risk, depending on whether it is a one-off

Some examples

Scenario	Risk and comments
Income distributed to bucket company and put on Div 7A complying terms. Non-resident is sole shareholder	High risk
Trustee determines to exclude capital gain from income and distribute income to controller of trust. Income is promptly paid.	Low risk given entitlement is to controller of trust
Trustee determines to exclude capital gain from income and distribute income to adult child. Income is promptly paid.	Medium risk as not in green zone.
Income distributed to bucket company an put on Div 7A complying terms	Low risk
Income distributed to bucket company and put on Div 7A complying terms. Trust is the sole shareholder of company	Medium risk

What to do for prior and future years

- Identify whether any 2014 arrangements continued
- Understand position in 2014 fact sheet and assess arrangements from 2014 – 2022 in this light
- Be aware of green zone arrangements, red zone arrangements, and paragraph 32 exclusions

Final thoughts and Q&A

Your Presenters

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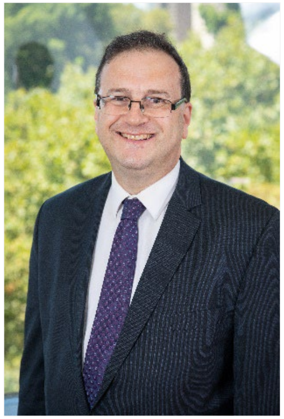

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