The ATO’s view on trusts
(and what to do about it)

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Section 100A and the ATO’s view of discretionary trusts

- Section 100A overview
- Current case law
- The Commissioner’s position
- Examples of current audit activity
- Trust ~~bashing~~ reviews in other areas
- Where this might be going
- How to advise your clients

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Section 100A – the mischief

- Section 100A was introduced in 1979
- Intended to combat dividend stripping schemes
- (Bottom of the harbour era)
- Introduced concept of ‘reimbursement agreements’

“Section 100A is designed to counter tax avoidance arrangements which are based on the introduction in a trust estate of a beneficiary who would be exempt from tax on any income of the trust estate, for example, an exempt institution. Under such arrangements, a “reimbursement agreement” would involve this introduced beneficiary passing all, or the major part, of the income to which it is presently entitled, but altered into a tax-free form, to the person or group of persons intended to enjoy the benefit of the trust income.”

- 1979 Explanatory Memorandum

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Section 100A – the mechanics

A beneficiary of a trust estate, who is not under a legal disability, becomes presently entitled as a result of a *reimbursement agreement*;

A reimbursement agreement is an agreement that provides for a payment to someone other than the presently entitled beneficiary;

The reimbursement agreement was entered into for a particular purpose (or for purposes that included a particular purpose) of reducing income tax; and

The agreement was <u>not</u> entered into in the course of <u>ordinary family or commercial dealing</u>.

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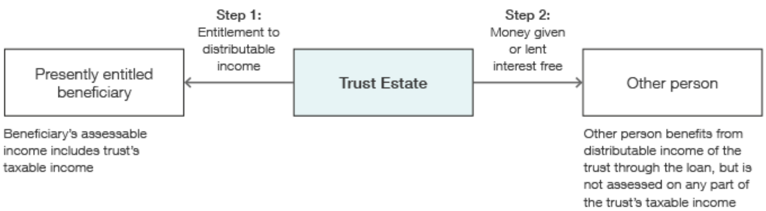
Section 100A – the mechanics



Section 100A – the mechanics

- Extended definitions:
- *Payment* includes payment of money (including by way of loan), or transfer of property, or provision of services or other benefits
- *Agreement* means any agreement, arrangement or understanding, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings…
- <u>…but does not include an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.</u>

Section 100A – cases

Re Kay Ann Stamp v Commissioner of Taxation [1988] FCA 352

East Finchley Pty Ltd v Commissioner of Taxation [1989] FCA 481

FCT v Prestige Motors Pty Ltd as trustee for the Prestige Toyota Trust (1998) 82 FCR 195

Idlecroft Pty Ltd v Commissioner of Taxation [2005] FCAFC 141

Raftland Pty Ltd as trustee for the Raftland Trust v Commissioner of Taxation [2008] HCA 21

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Section 100A – cases (cont…)

Re Lack and Commissioner of Taxation [2012] AATA 823

Nelson v Commissioner of Taxation (2017) 158 ALD 275

Hart v Commissioner of Taxation [2018] FCAFC 61

Guardian AIT Pty Ltd atf The Australian Investment Trust v Commissioner of Taxation QUD146/2020 [pending]

Alexander Springer v Commissioner of Taxation QUD147/2020 [pending]

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Section 100A – takeouts from cases

- Sham / Part IVA is easier than reimbursement agreements (*Stamp, Idlecroft, Raftland, Lack, Hart*)
- Blatant addition of beneficiaries (*East Finchley*, *Prestige Motors*) will likely be reimbursement agreement
- No decided cases on **ordinary family dealing**

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Ordinary Family Dealing

- *Newton v Commissioner of Taxation* on section 260
- *Peacock v FCT* 76 ATC 4375 and *Jones v FCT* (1977) 7 ATR 229 – ordinary family dealing so s260 did not apply
- *Gulland, Pincus Watson* [1985] HCA 83 – not ordinary family dealings

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Ordinary Family Dealing

Still a lot of uncertainty:

- Does a family dealing need to be commercial?
- Is a commercial dealing <u>not</u> a family dealing?
- What is ordinary? Ordinary for a particular family, or for society as a whole? What about different cultures?
- What about prior benefits? That is, record payments to minor children as loans to be repaid when they reach majority?
- Can a beneficiary make a gift of their trust distribution?

Ordinary Family Dealing – ATO view

ATO website (only at this stage):

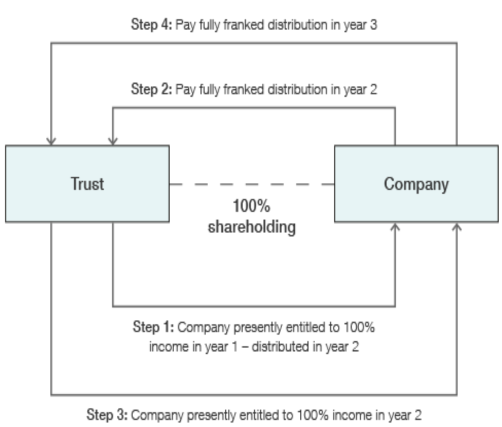
- An agreement won't necessarily be considered to have been entered into in the course of an ordinary family dealing merely because all of the entities involved are members of the same 'family group'.
- Bona fide loans are a feature of many ordinary commercial and family dealings.
- Where a trustee lends money on terms that require repayments of principal and interest, this would generally indicate an ordinary commercial dealing.
- **However, a loan made in the course of ordinary family dealings may qualify for the exclusion even if it is not made on commercial terms.**

Ordinary Family Dealing – ATO view

ATO website (only at this stage):

- Example 2 – PS LA 2010/4 subtrust is ordinary commercial dealing**.**
- Example 3 – testamentary trust for minor is ordinary family dealing.
- Example 4 – loan to beneficiary with principal and interest is ordinary family dealing / commercial dealing hybrid.
- Example 5 – washing machine arrangement is <u>not</u> ordinary family dealing…

Ordinary Family Dealing – ATO view



Section 100A, ATO audit activity

The following are some examples of current review activity:

- Distributions to adult beneficiaries
- Short term unpaid present entitlements (placed on complying PS LA 2010/4 terms, and repaid)
- Conversion of beneficiary loans to equity (unit trusts)
- Distribution from profitable trust to loss trust (genuinely within the family group).

Some observations about review / audit activity:

- Very slow developing
- Typically characterised by formal interviews and requests for information under section 353-10 Schedule 1 of *Taxation Administration Act* – everyone gets a turn.
- Extensive involvement with Tax Counsel Network.

Section 100A – what next?

- ATO draft ruling on *ordinary family or commercial dealings* (prepare for disappointment)
- Judicial clarification?
- Possible IGOT complaints?
- Broader themes involving discretionary trusts and professional practices:
  - *Greensill v Commissioner of Taxation – s855-10* CGT and foreign beneficiearies
  - PCG 2021/D2 (released 1/3/21)

Section 100A – advice to clients

- Ensure beneficiaries receive the actual cash comprising their trust distributions.
- Make it very clear that the beneficiaries are under no obligation to pay anyone – documentation such as deeds of gift, and even independent advice, would be best practice.
- Beneficiaries should be aware that their evidence may be critical to establish the timing of the reimbursement agreement.
- Be exceedingly careful with loss trusts – do not use them unless the benefit will remain with the trust (and consider what this means in practice).
- If a client is audited, advise them to be patient and not to take the formal interviews too personally (which also applies to their accountants).
- Ensure all dealings with companies are placed on complying PS LA 2010/4 terms.

Watch this space!!

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Thank you

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