

How 100A multiplies the compliance burden

TAX

The ATO's trust distribution ruling comes with a whole raft of requirements for consultation and documentation.

By [John Jeffreys](#) • 05 January 2023 • 9 minute read

With the finalisation of ATO documents TR 2022/4 and PCG 2022/2 in relation to section 100A ITAA 1936, accountants must now turn their minds to what they will require in practice. Will the requirements of the ATO, as set out in these documents, mean more work for accountants in relation to their trust clients?

Unless a client's trust affairs are relatively simple, I think it almost certain that if an accountant wants to follow what the ATO requires, particularly in relation to PCG 2022/2, there will be more work, at least in some or all the following ways:

- Discussions and consultation with clients and others
- Governance documentation
- Obtaining advice
- The "two-year rule"
- Documentation of the green zone status

Consultation with clients and others

The ATO documents will be a game changer for most accountants in the way they deal with their trust clients if they want their clients to be (relatively) safe from ATO section 100A investigations.

Trustees and beneficiaries (and perhaps others) will need to be made aware of the position the ATO has adopted in the documents. Tax agents are charged with a range of responsibilities under the legislation that governs tax agents and informing clients of what creates tax risks is part of that responsibility.

Also, without knowledge of what is said in the ATO documents, a trustee or beneficiary may inadvertently engage in a transaction, including a gift, that could exclude arrangements from the green zone and possibly put the arrangements in the red zone. Accountants are often unaware of what happens to distributions that have been paid to beneficiaries, so the only way to guard against an inadvertent action is to forewarn the client.

Also, it is abundantly obvious the decision concerning which beneficiaries are to receive distributions and what is done with the funds that represent those distributions will now need to be carefully thought out and discussed in some detail with clients. For accountants advising their trust clients, this will be a balancing act between:

- Cash flow requirements of, say, a business
- Funding needs of beneficiaries
- Whether arrangements can be kept within the green zone while satisfying family objectives
- The tax implications of whatever is decided
- The impact of the “two-year rule” (discussed later)
- Other factors

Governance documentation

With the greatest of respect to my fellow accountants, to put it frankly, we have a history of being a bit loose with trust documentation. In the good old days, accountants generally didn't worry too much about reading trust deeds, were often inaccurate with trust distribution minutes and the communication between trustee and beneficiaries was poor.

Following the Bamford High Court decision (2010) and other changes, documentation has been tightened up considerably. Distribution minutes are completed before year end and trustee documentation is more complete.

With the finalisation of the ATO documents, I am now telling my clients (accounting firms) that the old days of loose documentation are well and truly over. Accountants should now adopt the highest standard of trust documentation with their clients. Basically, this means making sure things are right. Proper communications should be sent between trustees and beneficiaries. Important trust decisions should be minuted — not just at year end. Loan agreements should be formalised ... and so on.

I recommend that accountants adopt an approach similar to them being an arm's length beneficiary in a trust situation. What documentation would they like to see?

Obtaining advice

Section 100A is complicated. Trust law is complicated. If you combine this with significant amounts of money, this is a recipe for a potentially large negligence action. If you place over that the fact that beneficiaries are becoming more litigious in relation to their potential entitlements, this can place an accountant in a difficult position. Accordingly, where appropriate, accountants must now consider, more than ever, taking legal advice from lawyers who understand trusts and their tax principles.

It must be said that many lawyers do not properly understand trust principles and, particularly the tax implications of trusts. So, advice must be taken from a lawyer that is a known expert in the area.

The “two-year rule” and trustee retention of funds

In the PCG, the ATO has created what could be referred to as a “two-year rule” in relation to the time delay between making a beneficiary presently entitled to an amount of trust income and paying out that amount to the beneficiary (see green zone scenario 2 for an example). That is, (broadly) the ATO will permit an arrangement to be in the green zone if

the beneficiary's entitlement is paid to them within two years (there are exceptions to this rule).

If a trust retains funds with the idea of following the two-year rule, the accountant will need to keep track of when beneficiaries have been made presently entitled to trust income and when those entitlements have been paid out. I would recommend that separate accounts be kept in the liabilities part of the balance sheet for this purpose.

With regard to trustee retention of beneficiary entitlements, the ATO, through the PCG, seems to have created two different types of trustee retention. One type is the two-year rule which I have just discussed. The other type is where the funds remain with the trustee for working capital purposes (known as the "trustee working capital condition" — see paragraph 25 of the PCG). Space does not permit a full discussion of this here, but this will be another compliance issue to which accountants must have regard.

Documentation of the green zone status

Paragraph 18 of the PCG states, "If you choose to rely on this guideline, you should document how your circumstances meet the requirement of the green zone." I think this will cause considerable difficulties for accountants and will be an unwanted extra compliance burden.

The PCG does not describe how one should document compliance with the green zone. Here is my suggestion as to how this might be done.

First, it seems mandatory that an accountant be very familiar with all the green zone scenarios and examples. If you are not familiar with these, how can you say your client's situation is within the green zone? I note that some of the green zone situations are described in TR 2022/4 as well as PCG 2022/2.

Second, you must carefully examine your client's situation and identify aspects of this situation that are similar to the green zone scenarios and examples. This will often not be a straightforward process because client situations will frequently differ (albeit, perhaps, not in great detail) from a green zone example.

Third, you must then examine what can exclude you from the green zone by being very familiar with paragraph 32 of the PCG. It is important that all accountants are well versed in what is said in that paragraph (I give an example below).

Accountants should understand that there will be many trust arrangements that fall neither within the green zone nor the red zone. Do not think that the green zone and red zone cover all trust arrangements. Many (perhaps most) arrangements will not fall within either zone.

Having done the aforementioned work, there should be a place in the file of the trust entitled "Documentation of green zone status". Here the accountant will set out why the trust arrangements are within the green zone and are not excluded from that zone.

Documentation — the gifting problem

Here I want to describe something that concerns me. It relates to the situation where a presently entitled beneficiary is paid their entitlement and then gifts that entitlement — not an unusual situation in a family.

I will start by saying very senior ATO officers have repeatedly stated that if a beneficiary is paid their entitlement, there is no section 100A risk. Jeremy Hirschhorn, second commissioner, said that this was the “touchstone” of the ATO’s position.

This statement is not correct. It is not supported by ATO documents.

The PCG clearly contemplates a beneficiary being paid their entitlement and then gifting that entitlement, with the result that this arrangement is not within the green zone unless where the gift meets the (rather narrow) requirements of green zone scenario 1.

This means that if an accountant is to document whether an arrangement is within the green zone (as the ATO requires) it will be necessary to ask beneficiaries to say (and possibly prove) what they have done with their entitlement. Unless the beneficiary has spent the money wholly on themselves or they have gifted the entitlement within the narrow requirements of green zone scenario 1, the arrangement will not be within the green zone and the accountant cannot document the arrangement as being so. Further, the accountant cannot say to their client that the client has no risk of a section 100A investigation by the ATO.

This is a most unsatisfactory compliance burden that will fall almost totally on accountants.

The PCG becomes the law?

Tax practitioners will point out that the PCG is not the law. This is true. However, for most accountants the PCG will, effectively, become the law. This is because neither they nor their clients will want to have a costly dispute over a section 100A assessment. So, in practise, most accountants (and their clients) will want to “swim between the flags” and try to place their trust arrangements within the green zone.

But, in order to do this, it seems to me it will be inevitable that there will be extra compliance costs.

Who’s paying?

I know every accountant reading this article will be asking, “Will the client pay for this extra work?” and I recommend accountants think deeply about how they are going to approach the new challenges created by the ATO documents so they achieve the best outcome for their clients while not leaving themselves out of pocket. Accountants need to get on the front foot with this matter and prepare their clients for possible changes with their 30 June 2023 distribution minutes and increased accounting fees.

30 June 2023

The end of the financial year is just six months away. I think I can predict, with some certainty, that the trust distribution, decision, calculation and documentation process for the coming financial year end will be more complex and take longer to complete. Accountants, be prepared!

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