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Why concerns linger over s100A final ruling

TAX

The ATO improves its guiding documents on trust distributions, but too much remains uncertain.

By Robyn Jacobson•03 February 2023•9 minute read

Section 100A of the *Income Tax Assessment Act 1936* (ITAA 1936) is an anti-avoidance provision that has been in the law since 1979 and applied since 1978. It was originally designed to prevent aggressive trust-stripping arrangements but the deliberately broad drafting of the provision encapsulates arrangements long thought to be outside its scope.

Broadly, s100A will apply to an arrangement where all the following criteria are satisfied:

- A beneficiary of a trust (who is not under a legal disability) is presently entitled to a share of the trust income, and is therefore assessed under section 97 of ITAA 1936 on that share of the trust's net income
- That present entitlement arises in connection with a reimbursement agreement — a reimbursement agreement is an agreement (whether or not written) that provides for money to be paid, property transferred, or services or other benefits provided to someone other than the beneficiary
- At least one of the parties to the reimbursement agreement entered into it with a purpose of reducing or deferring someone's income tax liability
- The arrangement was not entered into in the course of an "ordinary family or commercial dealing" (the primary exception)

The effect of s100A is to treat the beneficiary as never having been presently entitled to the share of trust income. This results in that proportionate share of the trust's net income being assessed to the trustee under s99A of ITAA 1936.

Few s100A cases have come before the courts over the past 40 years, and those that have were characterised by practitioners as being of the more egregious kind. Together with the legislative exception, this historical context contributed to the false notion that the provision doesn't apply more widely and is therefore not relevant to ordinary families.

The most concerning aspect of s100A is its unlimited amendment period, which allows the Commissioner to raise a liability against a trustee without the usual four-year limitation. This harks back to a different era and has no place in the current tax landscape. Even the anti-avoidance rules of last resort, Part IVA, have a four-year amendment period. S100A should have parity with Part IVA and be similarly limited.

Another concern is the low bar of “a purpose” of reducing tax. Part IVA applies only if an arrangement was entered into for the “sole or dominant purpose” of obtaining a tax benefit. S100A should be similarly confined.

However, the greatest angst and confusion stems from the use of the term “ordinary family or commercial dealing” in the exception. The propensity for widely different interpretations of the term “ordinary” heighten the risk of inconsistency, misunderstanding, prejudice and discrimination arising in the decision-making process and the application of s100A. The ATO has frequently stated that it will not be defining this term as it turns on the facts of each case. This makes the practitioner’s job of interpreting and applying the law to their clients extremely challenging.

These issues cannot be remedied through interpretation or the ATO applying an administrative approach. They are fundamental policy concerns that can be redressed only by legislative amendment.

The final guidance

The recently finalised ATO guidance, released on 8 December 2022, comprises:

- TR 2022/4 Income tax: s100A reimbursement agreements
- PCG 2022/2 s100A reimbursement agreements – ATO compliance approach
- An ATO media release
- Updated ATO web guidance

This guidance finalised the draft package released for comment on 23 February 2022 and is in addition to Taxpayer Alert TA 2022/1 — Parents benefiting from the trust entitlement of their children over 18 years of age, which was released on 23 February 2022.

TR 2022/4

The ruling is an improvement on its draft form. It better explains key concepts such as the ‘connection’, ‘benefit to another’ and ‘tax reduction purpose’ requirements.

Importantly, when explaining the ATO’s interpretation of the term ‘ordinary family and commercial dealing’, descriptors and terminology have been removed that could result in the use of value judgements. The ruling instead notes that the ‘ordinary family and commercial dealing’ exception may not be satisfied when the arrangement:

- Is artificial or contrived
- Is overly complex
- Contains steps that are not needed to achieve the family or commercial objectives
- Contains steps that might be explained by other objectives

PCG 2022/2

The PCG is also a big improvement on its draft form. Key changes include the removal of the proposed blue zone, the expansion of the green zone to include additional examples and scenarios and improved guidance on record-keeping requirements (discussed below).

The removal of the blue zone leaves just three risk zones. However, the reduction in the number of zones should not be conflated with an expectation of increased ease of characterising your clients' risk levels. Thousands of trust arrangements will fall outside the green zone (because they are not low risk) but fall short of being red zone (yet not high risk). This will leave many practitioners and taxpayers scratching their heads as to the likelihood of ATO compliance resources being allocated to review their arrangement to determine if s100A applies.

The zones indicate the risk level of the ATO applying compliance resources to review the arrangement, not the likelihood of s100A applying to the arrangement:

- White zone — the ATO will generally not commence new compliance activities to consider the application of s100A for income years ended before 1 July 2014
- Green zone — the ATO will generally not dedicate compliance resources to consider the application of s100A
- Red zone — the ATO will dedicate compliance resources to consider the application of s100A as a matter of priority

On one of the exclusions for an arrangement to fall outside the white zone, the ATO has clarified that an arrangement continues before and after 1 July 2014 if the present entitlement arose before that date and a present entitlement to another amount of trust income has arisen on or after that date.

What does this mean for practitioners?

It is important to understand that there has been no change to the law or the application and operation of s100A. The guidance is the Commissioner's interpretation of how the provision operates and how the ATO will assess the risk of certain arrangements.

Given this, practitioners should be mindful of the following:

- Franked distributions and capital gains: the ATO is of the view that where a beneficiary is no longer presently entitled pursuant to s100A, this also results in no beneficiary being specifically entitled. That is, the operation of s100A takes priority over the streaming rules in Subdivisions 115-C and 207-B of ITAA 1997. However, the interaction of these provisions will depend on the terms of trust deed.
- Date of effect: consistent with the draft guidance, the PCG applies to present entitlements arising before and after its release. However, the ATO has advised that it will not dedicate compliance resources to taxpayers who relied on, and took reasonable steps to comply with, the July 2014 website guidance.
- Period of review: s100A's unlimited period of review means that the trustee must retain sufficient records to explain transactions that have happened.

Record-keeping

The final PCG provides more detailed guidance on important documents that should be retained when evidencing arrangements. These include:

- 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 made aware of their entitlement
- Details, where possible, of how the present entitlement was satisfied by the beneficiary
- Details of how the funds were retained or utilised by the trustee to satisfy certain green zone conditions
- Copies of loan agreements and records showing how the loan repayments were satisfied

Although the PCG recognises that family arrangements are more likely to have imperfect records, it is still crucial that the trustee maintain contemporaneous records to evidence why the transaction occurred.

Guardian and BBlood

On 24 January, the Full Federal Court published its appeal decision in *Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3. It agreed with the primary judge that s100A did not apply to the two income years that were the subject of the appeal, dismissing the Commissioners appeal.

However, the court partially allowed the Commissioner's appeal in finding that, unlike the 2012 scheme, Part IVA did apply to the 2013 scheme.

In September 2022, Justice Thawley found that s100A applied to a share buy-back arrangement in *BBlood Enterprises Pty Ltd v Commissioner of Taxation* [2022] FCA 1112. The taxpayer has appealed this decision to the Full Federal Court.

Final comment

Although the finalised guidance is an improvement on the draft package and provides greater clarity for taxpayers on the ATO's approach to s100A, several policy issues continue to cause concern. The operation of the unlimited amendment period, the broad requirement that the agreement must be entered into for "a purpose" of reducing or deferring an income tax liability and the ambiguity that lingers around the term "ordinary" are matters for the legislature.

The ATO's guidance is based on existing case law and may be impacted by any changes in the judicial interpretation of s100A that arise from the appeals in Guardian and BBlood. The ATO should consider whether the ruling should be updated in light of the appeal decision in Guardian.

After an interesting year of discussing the implications of the draft guidance, it is now time for practitioners to consider how the final guidance will impact, change or affect their clients' intended trust distributions for 2022–23.

While the simple rule to prevent s100A from applying is for the cash to follow the distribution, this is not attainable or realistic for some groups of taxpayers. In circumstances where the cash is retained by the trustee or loans made are genuine and low risk, thankfully the ATO has allowed a little more leeway in accepting what constitutes a green zone arrangement. However, maybe the dust hasn't quite settled on those arrangements that fall within the red zone, or indeed sit between the two zones.

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